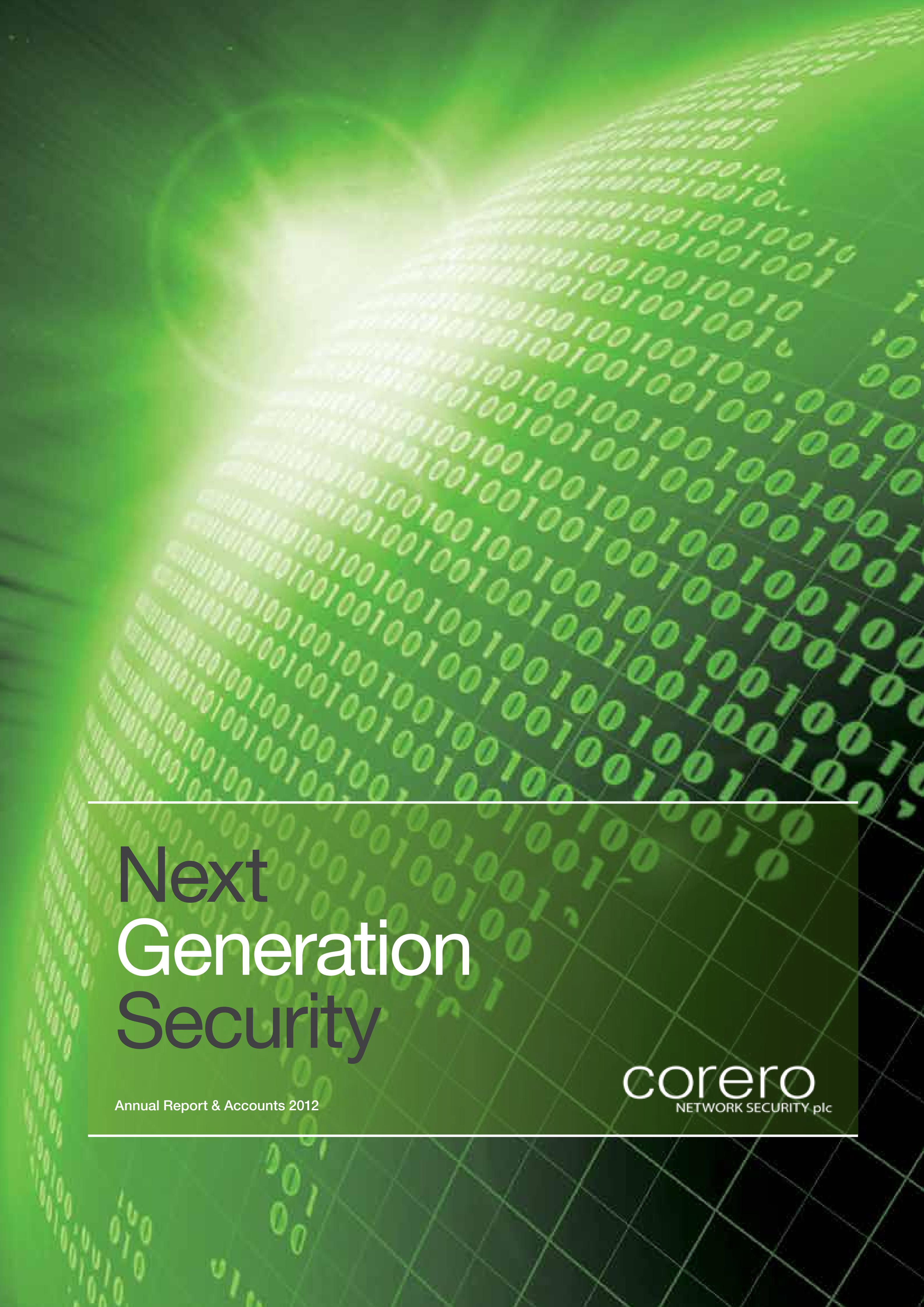


Next Generation Security

Annual Report & Accounts 2012

corero
NETWORK SECURITY plc

corero
NETWORK SECURITY plc

Corero Network Security plc ('Corero', the 'Group' or the 'Company'), is a software focused business with a leading position in its two markets: network security, and business management solutions.

Corero Network Security www.corero.com is an international network security company and leading provider of next generation security solutions. Deployed as a First Line of Defense solution, Corero's products and services sit outside a client's network, effectively stopping unwanted traffic (including Distributed Denial of Service ("DDoS") cyber-attacks) from reaching and overwhelming firewalls and other infrastructure components, such that good customer traffic can flow unimpeded.

Corero's First Line of Defense solution utilises sophisticated techniques and technologies to block malicious traffic to stop DDoS and other advanced cyber-attacks before they enter an organisation's IT infrastructure. This industry best practice is helping customers worldwide, including enterprises, service providers and government organisations, safeguard their IT infrastructure and eliminate downtime, ultimately protecting their bottom line.

Corero Business Systems www.coreroresource.com is a leading provider of powerful and dynamic modular accounting, human resources, payroll and management information software to the schools (including academies) and further education and commercial sectors in the UK and internationally. Corero has a strong background and pedigree in education having been involved in the sector since the early 1990's.

Corero's proprietary software solution "Resource" is at the core of the Corero suite of business applications:

- Resource Financials & HR – a finance and HR management solution delivering web-enabled and workflow controlled business processes.
- Resource EMS – a student record and learner management information solution for the post 16 education sector.

Contents

Highlights

Financial highlights

- Consolidated revenue $20.6 million (2011: $18.0 million)
- Consolidated EBITDA loss* $3.1 million (2011: profit $0.4 million)
- Loss per share 9.7 cents (2011: 5.3 cents)
- Cash of $4.9 million at 31 December 2012 (2011: $6.7 million)
- Raised $6.2 million (£4.1 million) (before costs) on 20 March 2013 by way of a placing

* before depreciation, amortisation, acquisition and restructuring costs and financing

Operating highlights

Corero Network Security division

- Successful launch of "First Line of Defense" offering to leverage its leading DDoS solution
- Ashley Stephenson appointed as CEO of CNS division
- Won 66 important new customers including a leading telecommunication service provider in Asia, Books.com, a Malaysian state ministry and a leading French retail group
- Ranked by Gartner as "a Visionary" in the IPS Magic Quadrant

Corero Business Systems division

- 251 new academy and schools customers driving strong and profitable growth
- Continued investment in software products (Resource Financials & HR and Resource EMS)
- Winner of The UK Business Software Industry Software Satisfaction Awards 2012 ("SSA12") in the category of Accounting & Finance (corporate)

"2012 was an important transition year for the Corero Network Security division. We are confident that the progress and investments made in the business, along with the appointment of Ashley Stephenson as Chief Executive Officer to drive forward its sales-led growth strategy, have positioned the business well for the future. We are excited about the market opportunity and the Corero Network Security division's growth prospects.

The Corero Business Systems division has delivered strong profitable growth in 2012 which is expected to continue in 2013 and beyond, providing very good cash generation on the back of sustained revenue increases."

Andrew Miller, Group COO

Business Profile

CORERO NETWORK SECURITY

www.corero.com

Vision

Global market leader of next generation cyber-threat defence products and services that enable Enterprise, Government and Cloud Service Providers to combat increasingly sophisticated unwanted network traffic to protect and optimise Internet facing businesses and organisations.

Market dynamics

Society's increasing reliance on the Internet has streamlined business efficiency and led to booming online revenue growth. Online sales, on what is termed in the United States Cyber Monday (November 26, 2012), approached $1.5 billion, up 30% from sales on the same day in 2011. This growth in online sales has created an explosion of cyber-attack entrepreneurs – looking to cash in on the growing digital marketplace.

According to the 2012 Verizon Data Breach Investigations Report, the number of compromised records skyrocketed to 174 million. It also found that external attackers were behind the majority (98%) of breaches. As the number of attacks increase, so do the financial consequences. Research published by the Ponemon Institute found a 42% increase in the number of cyber-attacks, with the average annualised cost of cyber-crime incurred by a benchmark sample of US organisations of $8.9 million. It noted that organisations experienced an average of 102 successful attacks per week, compared to 72 attacks per week in 2011. It cited distributed denial of service (DDoS) as a common attack type and one of the most costly cyber-crimes. With the growing number of attacks, the DDoS protection market is forecast to grow by 16% per annum to $485 million by 2016 (Infonetics Research).

With the number of successful attacks on the rise it is evident that existing firewall, intrusion prevention systems, and traditional security infrastructure are not equipped to combat them. These technologies were not built to stop many of today's attacks and are being overwhelmed by DDoS attacks, advanced evasion techniques, server side exploits and other unwanted traffic. Organisations will need to adopt a first line of defence to effectively combat these attacks which are increasing in number and sophistication.

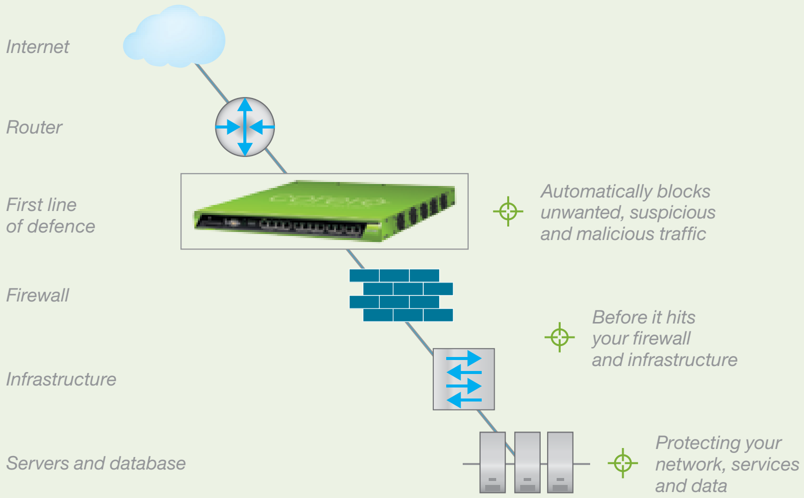
Technology for Today's Problems, Tomorrow's Challenges

As an organisations First Line of Defense, Corero's products and services stop unwanted traffic including DDoS attacks and intrusions at the perimeter to protect IT infrastructure, eliminate downtime and ensure the uninterrupted flow of revenue generating traffic.

Corero's First Line of Defense

Corero's First Line of Defense defines the network perimeter to be in front of the firewall. The First Line of Defense stops increasingly sophisticated unwanted traffic, which is intended to flood or otherwise harm the IT infrastructure, before it hits the firewall. This ensures availability for legitimate users.

This First Line of Defense provides deep-packet inspection to dynamically detect and stop flooding attacks, server-targeted malware and other exploits designed to compromise systems or access sensitive and confidential data.



Organisations need to shore up their network perimeter with a new security device, purpose built to detect and stop unwanted traffic before it can overrun the firewall and expose IT infrastructure to performance issues, compromise or catastrophic failures.

The Real Core is Service

Corero believes that the best security technology requires best-in-class services to assure customers' protection and success. Corero's services include:

- Threat Update Service, an automated protection update service that provides customers with timely pro-active protection from the latest security threats (including malicious software threats);
- ReputationWatch™ which identifies in real-time known malicious entities and blocks access to 'bad' IP addresses 'on-the-fly' based on reputation or geographic origin, to dynamically prevent DDoS attacks and other attack activity. ReputationWatch™ provides dynamic real-time configuration changes in response to the latest intelligence so that organisations are defended from all types of attacks including: known sources of DDoS; Bots that fall within identified botnet command structures; systems delivering specially crafted exploits such as KillApache; identified sources of malicious content attacks; phishing sites and Spam sources.
- SecureWatch®, an operational security service which ensures that Corero's solutions are always current and in the highest state of maintenance, so that customers' networks are protected around the clock against the latest threats.
- SecureWatch® PLUS, a comprehensive suite of monitoring and response services for DDoS-defence and unwanted traffic control at the perimeter. With SecureWatch® PLUS, customers receive expert DDoS defence services starting with the organisation-specific implementation, continuing with round-the-clock monitoring, and immediate and effective response in the event of an attack.

Benefits of Corero's First Line of Defense

Stop DDoS Attacks

- Stop perimeter security breaches
- Protect the web presence
- Greater visibility into attack vectors

Protect IT Infrastructure

- Remove unwanted traffic from the existing network
- Improve performance of the IT infrastructure
- Extend usable life of IT assets

Eliminate Downtime

- Ensure business continuity
- Measurably reduce costly outages
- Improve the customer experience

Corero's Customers

Corero's First Line of Defense network security products protect customers across all industries against cyber-attacks. Currently Corero's core vertical markets are: finance and banking, power and energy, education, defence, on-line gaming and e-Commerce.

Customers include some of the world's largest service providers (including BT, BSkyB, Telefonica, Telekom Malaysia, SFR and Verizon), and:

- Applied Innovations – web hosting provider, hosting 35,000 websites worldwide
- Brady Distributing – second largest distributor in the US of amusement games and vending machines
- Bridgepoint Education – on-line and campus based Higher Education provider
- bwin – leading on-line gaming company
- Camelot – UK based international lottery operator
- City Index – a leading UK financial services provider
- Fastmetrics – a full-service Internet service provider
- GamersFirst (part of the K2 Network) – company serves more than 28 million gamers in 160 countries, offering a range of multiplayer online games as well as rich community features
- Hyve – a UK based cloud hosting provider
- Journal Register – one of the largest newspaper publishers in the US
- Laclede Gas Company – leading US-based natural gas distributor
- Pep Boys – multi-billion automotive services and retail chain with more than 700 stores across the US and Puerto Rico
- Phase 2 – Hawaii-based leading software-as-a-service provider servicing the federal and enterprise markets
- San Miguel County, a county of the State of Colorado, US
- Zacks Investment Research – one of the most highly regarded firms in the investment industry

CORERO BUSINESS SYSTEMS

www.coreroresource.com

Vision

Leading strategic business software provider in the schools and further education sectors in the UK and internationally both directly and through partnerships.

Business enabling software

Corero is a provider of business accounting, human resources, payroll and learner management information software solutions to the schools and academies, further education and commercial markets. Corero's proprietary software solution, Resource™, is the core of the Corero suite of business applications. Resource empowers business and finance departments by providing streamlined processes which offer increased efficiencies, help to control costs and improve an organisation's cash flow management, all of which address the challenges for public sector and commercial organisations faced with tighter funding and increased competition.

The two core Corero Resource software solutions are:

- Resource Financials & HR ("Resource Financials"), a financial, procurement, billing, projects, human resources and payroll software solution; and
- Resource Education Management System ("Resource EMS"), a learner management information system for the post 16 education sector.

Resource Financials & HR

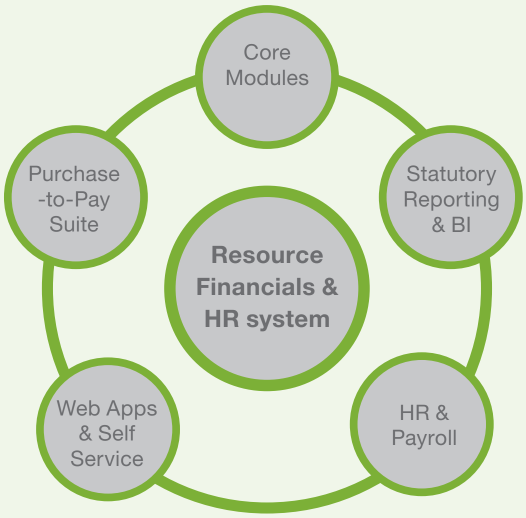
Corero Resource Financials is a powerful, flexible system which helps perform both every day and strategic financial and business process management tasks quickly and easily – improving efficiencies and reducing business administration costs.

Corero's award winning, integrated software allows customers to:

- Process transactions faster and with greater efficiency thus reducing cost;
- Significantly increase the visibility of key business performance indicators;
- Leverage and manage revenue opportunities;
- Automate and control the management of business expenses;
- Improve access to information by providing clear financial reports available in real-time and on-line; and
- Significantly reduce and even eliminate paper through sophisticated, automated workflow and document management.

Key features include:

- Core financial ledgers including Nominal Ledger, Purchase Ledger, Sales Ledger and Cash Book;
- Strategic and statutory financial management and reporting;
- Sophisticated billing and debt management including cash flow forecasting;
- Fully automated 'Purchase-To-Pay' system with on-line requisitions and purchase ordering;
- Full commitment accounting and reconciliation;
- Integrated project ledger including Time & Expense systems;
- Asset management and tracking with bar code scanning;
- Document management and scanning subsystem;
- Fully integrated HR suite covering recruitment, absence management, reviews & tracking, pay & benefits, personal development and employee self-service; and
- HMRC Accredited and 'RTI' ready Payroll solution.



Corero Resource Financials combines seamlessly with Corero Resource Web, HR & Payroll, and provides senior managers and budget holders with on-line management information and reports in real time such as the current status of their budget with visibility of current commitments and details of previous spending with full transaction drill down.

Resource EMS

Corero Resource Education Management System (Resource EMS) is specially designed to meet the challenges of the post 16 education sector.

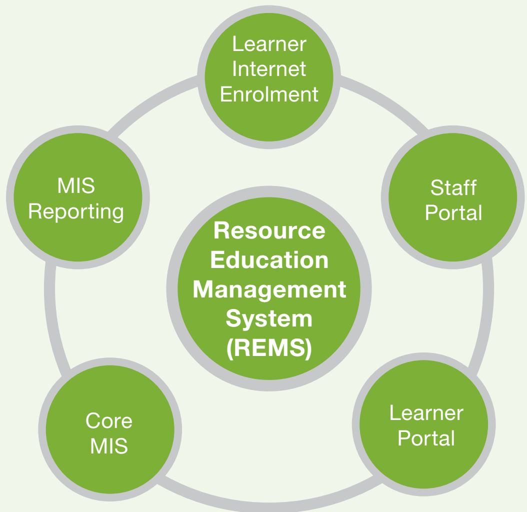
Key student, course and employer data is fully integrated, centralised and accessible on-line in real time which enables colleges to:

- Create individual learner records via user-definable, on-line enquiry, application and enrolment processes;
- Plan and monitor course profitability;
- Quickly identify requirements for Special Educational Needs/Additional Learner Support;
- Monitor student progress on-line in real time;
- Engage with local business community to exploit training opportunities;
- Generate all returns and reports for statutory bodies; and
- Measure improvement across the college through dashboard/KPI reporting.

Corero Resource EMS combines seamlessly with all other Corero Resource products, to produce one integrated solution, 'Corero Resource ERP for Education'.

Key features include:

- Full learner administration management from enquiry and enrolment to leaving;
- Course/programme planning and examination management tools;
- Individualised learner record (ILR) management;
- On-line timetabling and registers including student mobile options;
- Real time, online 'Portal' information delivery to tutors, learners and parents; and
- Simple, at-a-glance reporting and analysis.



Corero's Customers

Resource Financials

Corero is recognised as a market leading provider to the education sector. Resource Financials customers include over 580 academy trusts, federations and individual academies and schools (with some 22% of academies in England using Corero's software) and over 100 colleges.

Schools and academies including:

- The Cabot Learning Federation
- The Kemnal Academies Trust
- Landau Forte Academy Trust
- St. Mary Magdalene Academy
- The School Partnership Trust
- Walsall Academy

Further Education and Sixth Form colleges including:

- Dumfries & Galloway College
- Heythrop College
- Mid Kent College
- Peterborough Regional College
- Truro College

In addition, Corero has over 50 commercial customers including architects, consulting engineers, market research and design companies such as:

- British Bankers Association
- Fountain Television
- IFF Research
- RSA Films
- W A Fairhurst & Partners

Resource EMS

Resource EMS is used in over 40 Sixth Form and Further Education College Customers including:

- Cirencester College
- Mid Kent College *
- North West Kent College *
- Oxford & Cherwell Valley College *
- South Staffordshire College *
- St Dominics Sixth Form College

* Also use Resource Financials & HR

Corero Resource Financials & HR software won The UK Business Software Industry Software Satisfaction Awards 2012 in the category of Accounting & Finance (corporate).

SSA12 THE UK BUSINESS SOFTWARE INDUSTRY AWARDS 2012 WINNER CORERO RESOURCE

Chairman's Statement

"The strategy for the Corero Network Security division is to exploit the opportunity to provide cyber security attack mitigation defences in a rapidly growing market including DDoS protection products configured for either on-premise or cloud solutions."

Jens Montanana
Chairman

Presentation currency

Subsequent to the acquisition and integration of the US based Corero Network Security division (formerly Top Layer Networks) during 2011, the Group's presentation currency has been changed to US Dollars ("$") which is more closely aligned to the profile of the Group's revenue and cost base. The change is effective from 1 January 2012 and thus the results for the 12 months ended 31 December 2012 are reported in $. The average $-GBP sterling ("GBP") exchange rate, used for the conversion of the statement of comprehensive income, for the 12 months ended 31 December 2012 was 1.59 (2011: 1.60). The closing $-GBP exchange rate, used for the conversion of the Group's assets and liabilities, at 31 December 2012 was 1.63 (2011: 1.55).

Results highlights

In the year ended 31 December 2012 the Group reported revenues of $20.6 million (2011: $18.0 million) and an EBITDA loss before depreciation, amortisation, acquisition and restructuring costs and financing of $3.1 million (2011: profit $0.4 million).

Corero Network Security division review

CNS reported revenue of $11.4 million (2011: $11.0 million) and an EBITDA loss before depreciation, amortisation, acquisition and restructuring costs and financing of $5.0 million (2011: $0.9 million).

In September 2012, CNS launched its "First Line of Defense" solution to leverage its industry leading Distributed Denial of Service ("DDoS") protection and intrusion prevention technology. Sales order intake (bookings as opposed to amounts recognised as revenue) in the 12 month period ended 31 December 2012 was $10.4 million (2011: $12.0 million). Sales order intake was impacted by the repositioning of the CNS division around its new First Line of Defense solution in the second half of the year.

In 2012, 44 new partners were recruited bringing the total number of partners at 31 December 2012 to over 80. The First Line of Defense positioning has been well received by important new customers and partners as a compelling and differentiated offering.

Ashley Stephenson, who joined CNS in March 2012 as Executive Vice President Product Marketing and Strategy, was appointed Chief Executive Officer of the CNS division in January 2013 as a result of a leadership reconfiguration to position the business for a sales led growth strategy and to build upon the progress made in the product development, marketing and operational aspects of the business in 2012.

Highlights of 2012 include:

- Business continues to win important new customers
- Investment in the commercialisation of SecureWatch and SecureWatchPLUS services
- Launched "ReputationWatch" which blocks known malicious entities in real-time to dynamically prevent DDoS cyber-attacks
- Ranked by Gartner as "a Visionary" in the IPS Magic Quadrant

New customer wins in 2012 included significant orders from: Agarik (a leading French web hosting and managed service provider); a leading telecommunication service provider in Asia; Books.com; a Malaysian state ministry; Hyve (a UK based cloud hosting provider); a leading French retail group; and a leading international provider of financial technology to banks and corporations.

Material orders (upgrades and support contract renewals) in 2012 from existing customers included: the world's leading online gaming

"We haven't experienced any successful attacks (since implementing Corero's solution). We haven't had anyone penetrate our networks. Another value add was the support provided by Corero. They were outstanding."

Oleg Voloshin, Chief Technology Officer,
Zacks Investment Research,
Corero Network Security customer

company; a Swiss-based telecommunication service provider; a leading international credit card processing company; one of the largest telecommunication service providers in Europe and South America; City Index; a leading price comparison website; a leading UK-based on-line gaming company; a leading international energy group and one of the largest insurers in the US.

The security market dynamics and opportunity for Corero Network Security

The market demand for security products and services continues to be driven by the growing threat landscape and increasingly influenced by the more widespread attack patterns. Organisations globally have to face constant threats originating from economically, criminally and politically motivated cyber attackers, with an increasing business impact as organisations become commercially more reliant on the Internet. The huge growth in online business and Internet financial transactions has created an explosion of cyber-attack entrepreneurs looking to cash in on the burgeoning digital marketplace.

- According to a PriceWaterhouseCoopers survey published in April 2012, most companies had a security breach in 2011 with the level of attacks double that in 2010 (organisations had an average of 54 significant attacks by an unauthorised outsider in 2011).
- Research published by the Ponemon Institute found that occurrences of cyber-attacks is mounting, with a 42% increase in the number of cyber-attacks in 2011. The research reported an average annualised cost of cyber crime incurred by a benchmark sample of U.S. organisations of $8.9 million. It also noted that organisations experienced an average of 102 successful attacks per week, compared to 72 attacks per week in 2010. It cited DDoS as a common attack type and one of the most costly cyber crimes.
- Forrester research shows DDoS protection is one of the top five security technology growth opportunities for the next three years given the increase in hactivism.
- A December 2012 Ponemon Institute survey of 350 retail banks revealed that 64% of banks were hit by at least one DDoS attack in the past 12 months (48% hit by multiple DDoS attacks) and that 78% of banks expect that attacks will continue or significantly increase.

There is heightened awareness in governments to the increasing cyber security challenge which is driving awareness in both commercial and government organisations:

- UK Cabinet Office minister Francis Maude commented in his December 2012 Cabinet office statement "The Internet has revolutionised the way we do business and is driving growth – the UK's Internet-related market is now worth £82 billion a year and this is set to rise. Cyber-attacks are one of the top four threats to our national security and cyber crime is costing our economy billions of pounds a year. And as businesses and government move more of their operations online, the scope of potential targets will continue to grow. It's a race: to build sufficient cyber defences to match the growing volume and dependence of our online economic, security and social interests."
- The Obama administration has recently urged organisations to implement stronger firewalls and other systems to provide a first line of defence for better resiliency to cyber-attacks.

In the last year there has been a significant increase in unwanted, suspicious and malicious traffic arriving

"Resource 32000 is a system that is user friendly, and comprehensive enough to meet all our reporting requirements including fulfilling companies house accounts regulations."

Barnby Road Primary School,
Corero Business Systems customer

"The strategy for the Corero Business Systems division will be to continue to invest for growth. The focus will remain on the education sector where the business has a strong market position, particularly in the further education college and academy and schools markets in England."

Jens Montanana
Chairman

via the Internet, breaching enterprise networks and compromising the performance of online services. With the number of successful attacks on the rise it is evident that existing firewall, intrusion prevention systems, and traditional security infrastructure are not equipped to combat them. These technologies were not built to stop many of today's attacks and are being overwhelmed by DDoS attacks, advanced evasion techniques, server side exploits and other unwanted traffic. As a result, a market is emerging for new security solutions that are deployed in front of the traditional firewalls, with the primary business driver being DDoS protection.

Corero has a first mover advantage in this market - and plans to reinforce this advantage through its investment in a next generation product to establish a leadership position. With the increase in the prevalence of malicious activity - particularly DDoS attacks - organisations, most notably in financial services and ecommerce verticals, are starting to include DDoS protection investment in their IT security budgets. Research by Forrester confirms that 42% of organisations expect to increase network security spend in 2013 with 24% of security budgets allocated to network security. The DDoS prevention appliance market is forecast by Infonetics to grow from $270 million in 2012 to $485 million in 2016.

Corero Business Systems review

Revenues for the CBS division increased by 30% in 2012 to $9.2 million (2011: $7.0 million). CBS sales order intake in the year to 31 December 2012 was $10.5 million (2011: $8.1 million).

CBS reported an EBITDA profit before depreciation, amortisation, acquisition and restructuring costs and financing of $3.1 million (2011: $2.6 million).

The CBS division won new contracts from 251 academies and schools in the 12 months ended 31 December 2012 (2011: 192) for its Resource Financials & HR software solution, underlying its strong position in this growth market. In addition, despite the tight Public Sector spending environment, CBS won 3 new contracts (2011: 3) from sixth form colleges in the 12 months ended 2012 for its Resource EMS learner management system.

Key achievements in 2012 include:

- Expansion of schools managed by Multi Academy Trust customers: The Kemnal Academies Trust adding 24 schools and the School Partnership Trust adding 15 schools.
- New academy trust groups signed including: REACH 2, Outwood Grange Academy Trust and London Diocesan Board for Schools.
- Appointment of Mike Stansfield as Product Development Director who brings 25 years' IT industry experience with leading companies such as Taxsoft, Sage, QSA and Pitney Bowes.
- CBS' Resource Financials product was announced as the winner of The UK Business Software Industry Software Satisfaction Awards 2012 ("SSA12") in its category.
- Achieved full ISO9001 Accreditation status.

The UK education market dynamics and opportunity for Corero Business Systems

The key growth market for Corero Business Systems is the schools market (including academies and free schools). The academy conversion programme is a key part of the Government's education policy. As of 1 January 2013, only 12% of the 21,000 schools in England were academies.

There continues to be strong interest from Local Education Authority controlled schools to convert to academies, encouraged by The

"We're very security conscious. We take our responsibility to protect our customers' data very seriously. One of our key criteria was inspected throughput for the invested dollar. Corero meets our demanding requirements, including the need for very low latency."

Kevin Doherty, President of Phase 2,
Corero Network Security customer

Department of Education, coupled with the emergence of academy groups including CBS customers, the School Partnership Trust (based in Leeds) and The Kemnal Academies Trust (based in Kent), each with 30 and 32 academies respectively at 31 December 2012.

Business strategy

The Corero Network Security division's strategy is aimed at exploiting the opportunity to provide cyber security attack mitigation defences in a rapidly growing market, including DDoS protection products configured for either on-premise or cloud solutions. If CNS can capitalise on this exploding opportunity, with its recently launched and differentiated First Line of Defense offering, we would expect to see strong revenue growth emerging from 2013 and beyond.

CNS is also investing in a next generation product to increase its addressable market. This product, the initial release of which is anticipated for later in 2013, is aimed at extended deployments in cloud infrastructure, virtual environments, and in very large scale networks.

The strategy for the Corero Business Systems division is to continue to invest for growth and remain focused on the education sector where the business has a strong market position, particularly in the further education college and academy and schools markets in England. The potential also exists to consider expansion into international markets. The CBS division plans to make further investment in its existing products, including plans for a Software-as-a-Service (Saas) enabled finance software product. These plans will be funded from existing resources and the on-going profitable trading of the division.

The Group will continue to manage and operate as two separate divisions with a small central head office overhead.

Staff

Our employees include highly skilled developers, and experienced management, sales executives and support staff, all focused on delivering market leading solutions to our customers. On behalf of the Board, I would like to thank the employees of Corero for their efforts in the last financial year.

Directorate

I would like to thank Edward Forwood and Stephen Graham who resigned from the Board in March and June 2012 respectively, for their contribution and welcome Andrew Lloyd who was appointed to the Board in November 2012.

Outlook

Significant progress has been made in the Corero Network Security business. The business and management team have been reorganised and the groundwork laid to drive incremental growth in new international markets. This division is well positioned to deliver growth in 2013. Corero Network Security has had an encouraging start to 2013 with material business wins generated from both new and existing customers. New customer wins include: a US utility, a leading mobile service provider in Brazil, and an Internet domain services company. Existing customer renewals include a leading European lottery operator, one of the largest insurers in the United States, and a leading price comparison web site.

The Corero Business Systems division performed strongly in 2012 with this growth expected to continue. The division plans to make further self-funded investments in its products and to consider adjacent market opportunities. Corero Business Systems has had an encouraging start to 2013.

Jens Montanana

Chairman
25 March 2013

"I have really enjoyed using Corero Resource and have found it extremely easy to use. It has been a pleasure dealing with Corero; any queries have been handled immediately and professionally."

Heart of England Business and Enterprise School,
Corero Business Systems customer

Financial Review

for the year ended 31 December 2012

"We are confident that the progress and investment made in the Corero Network Security division, the Q3 2012 positioning as a First Line of Defense and the appointment of Ashley Stephenson as CEO to drive forward its sales-led growth strategy, have positioned the business well for the future."

Andrew Miller
COO and Executive Director

Financial performance

For the year ended 31 December 2012, the Group reported an EDITDA loss before depreciation, amortisation, acquisition and restructuring costs and financing of $3.1 million (2011: profit $0.4 million) and a loss after taxation of $5.9 million (2011: $2.0 million). This included an unrealised exchange loss of $0.3 million (2011: $0.1 million) arising on an intercompany loan.

Central costs were $1.2 million (2011: $1.2 million) which relate to the Group's finance and administration functions as well as the costs associated with the Company's listing on AIM.

Interest costs were $0.5 million (2011: $0.4 million) comprising interest on the Loan Notes issued by Top Layer Networks, Inc. ("Top Layer" subsequently renamed Corero Network Security, Inc.) as part of the purchase consideration for Top Layer and the Corero Network Security working capital facility.

Interest received was $0.1 million (2011: $0.1 million).

The loss per share was 9.7 cents (2011: 5.3 cents).

The Group's net assets at the year end were $19.3 million (2011: $17.8 million).

Performance indicators

The directors and managers of the Group monitor a number of metrics, both financial and non-financial, on a monthly basis. The most important of these are as follows:

- Revenue: $20.6 million for the year ended 31 December 2012 (2011: $18.0 million);
- Gross margin: 75% for the year ended 31 December 2012 (2011: 77%);
- Number of employees: 152 at 31 December 2012 (2011: 130); and
- Cash: $4.9 million at 31 December 2012 (2011: $6.7 million)

Whilst the CNS division's sales growth in 2012 (revenue $11.4 million compared to $11.0 million in 2011 for the 10 month period from the 2 March 2011 acquisition date) was disappointing, we are confident that the progress and investment made in the business, the Q3 2012 positioning of CNS' proposition as a First Line of Defense and the appointment of Ashley Stephenson as Chief Executive Officer to drive forward its sales-led growth strategy, have positioned the business well for the future. Despite revenue being below expectations, CNS continued its investment in product development and in the third quarter of 2012 commenced the development of its next generation product as the Board believes this investment is important for CNS to increase it addressable market and revenue in the future. Operating expenses increased from $9.2 million in 2011 (a 10 month period) to $13.2 million in 2012 predominantly as a result of the increase in headcount from 73 employees at 31 December 2011 to 90 employees at 31 December 2012 and the full year impact of the increase in headcount of 19 employees in the second half of 2011. The lower revenue growth and continued investment resulted in an operating loss of $7.4 million for the year ended 31 December 2012 (2011: $2.6 million).

The CBS division delivered strong profitable growth in 2012 (revenue $9.2 million compared to $7.0 million in 2011). Operating expenses increased from $3.1 million in 2011 to $4.1 million in 2012 predominantly as a result of the increase in headcount from 53 employees at 31 December 2011 to 58 employees at 31 December 2012 and the full year impact of the increase in headcount of 15 employees in the second half of 2011. CBS reported an operating profit of $2.7 million for the year ended 31 December 2012 (2011: $2.2 million).

"Corero is the new IT perimeter. Adding it to our arsenal of best-of-breed offerings perfectly rounds out our network security portfolio. By stopping all the known and unknown traffic at the perimeter, Corero's solutions guarantee uptime while ensuring our customers' are able to maximize their existing IT infrastructure investment, from their next generation firewalls to their IPS devices, and remain secure."

John Harris, Director of Sales, AE Business Solutions, Wisconsin IT solutions provider
Corero Network Security channel partner

Cash and treasury

The closing cash balance was $4.9 million (2011: $6.7 million). The net reduction in cash from operating activities was $5.1 million (2011: $1.6 million).

In 2012, the Company raised $7.2 million (£4.6 million) (before expenses) of which the directors and senior management contributed $2.2 million (£1.4 million).

At the end of the year, the Group had aggregate banking facilities of $2.8 million which are committed for a period of one year and are repayable on demand. Group companies have complied with the financial covenants relating to these facilities.

Taxation

As a result of losses carried forward in the UK subsidiary and losses in the US acquired through the acquisition of Top Layer, the Group does not expect to pay the full rate of UK or US corporation tax for a number of years.

At 31 December 2012, the Group had unutilised tax losses carried forward of approximately $37.7 million (2011: $31.4 million). This comprised UK tax losses of $10.0 million and US tax losses of $27.7 million. $4.2 million of the tax losses relates to US capitalised R&D deductions which will be available at an accelerated level for 4 years. $9.0 million of the tax losses relate to pre-acquisition US tax losses which can be offset against taxable profits over 19 years (there is a limit on the utilisation of pre-acquisition tax losses of $0.7 million per annum and any unused loss may be carried forward to subsequent periods). Given the varying degrees of uncertainty as to the timescale of utilisation of these losses, the Group has not recognised $11.6 million of potential deferred tax assets associated with these losses.

Dividends

The Board is not recommending the payment of a dividend (2011: nil).

Principal risks and uncertainties

The Directors believe the following risks to be the most significant for the Group. However, the risks listed do not necessarily comprise all those associated with the Group. In particular, the Group's performance may be affected by changes in market or economic conditions and in legal, regulatory and tax requirements. If any of the following risks were to materialise, the Group's business, financial condition, results or future operations could be materially adversely affected. Additional risks and uncertainties not presently known to the Directors, or which the Directors currently deem immaterial, may also have an adverse effect upon the Group.

1. Competition

The Group operates in competitive markets with Corero Network Security and Corero Business Systems business' main competitors being much larger companies with significant financial resources. The Group has experienced, and expects to continue to experience, competition from a number of companies. This competition may take the form of new products and services to better meet industry needs and to enable competitors to respond more quickly to client requirements. Further, if the market for the Group's products does not develop as it expects or if it fails to respond to market and competitive developments, the Group's business and prospects could be materially adversely affected.

The network security market, in particular, is becoming increasingly competitive and the Group may face significant competition, including from competitors who have greater capital resources than the Group. There is no assurance that the Group will be able to compete successfully in such a market place. The Board is aware of this threat

"The beauty of Resource for me is that it is an extremely powerful and flexible system that is also very easy to understand and use."

Loughborough College,
Corero Business Systems customer

"The Corero Business Systems division delivered strong profitable growth in 2012 with revenue of $9.2 million compared to $7.0 million in 2011."

Andrew Miller
COO and Executive Director

and intends to continue to invest in the enhancement of the Group's products and services.

A careful watching brief is maintained on competitors to enable the Group to react quickly to any change in circumstance or technical developments.

2. Technology and market requirements

The markets the Group operates in are fast changing, driven by changing customer requirements and technology trends. As such the Group's solutions require on-going development and enhancement to meet the needs of customers in its target markets. The Group's ability to anticipate changes in technology and customer requirements and to develop successfully and introduce new and enhanced solutions on a timely basis will be significant factors in the Group's ability to grow and remain competitive.

The ability of the Group to invest in such development is dependent on new business generation and future cash flows. There can be no assurance that the Group will have sufficient resources to make such investments, that these investments will bring the full advantages or any advantage as planned or that it will not encounter technical or other difficulties that could delay the introduction of new technologies or enhancements in the future. The Group's failure, for technological or other reasons, to develop in a timely manner, and market, products or services incorporating new technologies could have a material adverse effect on its revenues, results of operations and/or prospects.

3. Technology Partners

Corero Network Security's First Line of Defense solutions utilise a multi-core processing chip produced by Tilera Corporation. Should the supply of these chips by Tilera Corporation be interrupted or if this relationship was lost, this could result in a material adverse impact on the Group's financial performance. The Group maintains a close relationship with Tilera Corporation to reduce the risk of loss of this relationship.

4. Key management

The Group depends on the recruitment and retention of the services of its key technical, sales, marketing and management personnel. Competition for such personnel can be intense, and the Group cannot give assurances that it will be able to attract or retain such staff. The Group seeks to address this risk by ensuring that suitable and competitive remuneration structures are in place.

6. Dependence upon key intellectual property

The Group's success depends in part on its ability to protect its rights in its intellectual property. The Group relies upon various intellectual property protections, including patents, copyright, trademarks, trade secrets and contractual provisions to preserve its intellectual property rights. Despite these precautions, it may be possible for third parties to obtain and use the Group's intellectual property without its authorisation and as such the Group may become involved in litigation which could be costly and time consuming.

"DDoS attacks cost us thousands of dollars an hour. It's all the money that players can't spend and we can't get. [With Corero] DDoS doesn't affect us the way it used to. Without Corero, we would be seeing slow response times. But now it doesn't get to that point."

Matt Gee, Network Engineer at GamersFirst,
Corero Network Security customer

7. System failures and breaches of security

The successful operation of the Group's business depends upon maintaining the integrity of the Group's computer, communication and information technology systems which are vulnerable to damage, breakdown or interruption from events which are beyond the Group's control. All systems are backed up on a regular basis and appropriate investment is made in systems infrastructure within the Group to maintain appropriate standards of integrity and security.

8. Further issues of Ordinary Shares and access to finance

It may be necessary for the Company to raise additional capital by way of the further issue of ordinary Shares to enable the Group to progress through further stages of development. Any additional equity financing may be dilutive to shareholders. There can be no assurance that such funding, if required, will be available to the Company.

Andrew Miller

Director

25 March 2013

"We had a high-profile Wall Street firm that was under constant DDoS attack with more than 10,000 attackers at one point hitting them from almost every country in the world, overtaxing their firewall and bringing their sites to a standstill. None of their clients were able to access any of their websites. They were, to say the least, not happy. Though the firewall vendor had claimed to offer DDoS protection we quickly learned that this was not the case. We needed something that was specifically designed to handle this type of traffic. The Corero First Line of Defense product was installed and within hours the attacks were mitigated and the site performance returned to normal."

Colin Ryan, General Manager of Dynamic Business Systems,
Corero Network Security channel partner

Directors' Biographies

Jens Montanana

Non-executive Chairman

Age: 52

Appointed: 9 August 2010

Jens is the founder and CEO of Datatec Limited, established in 1986. Between 1989 and 1993 Jens served as managing director and vice-president of US Robotics (UK) Limited, a wholly owned subsidiary of US Robotics Inc., which was acquired by 3Com. In 1993, he co-founded US start-up Xedia Corporation in Boston, an early pioneer of network switching and one of the market leaders in IP bandwidth management, which was subsequently sold to Lucent Corporation in 1999 for $246 million. In 1994, Jens became CEO of Datatec Limited which listed on the Johannesburg Stock Exchange in 1994 and on AIM in 2006. He has previously served on the boards and sub-committees of various public companies. Jens is chairman of the Corero Remuneration Committee.

Andrew Miller

Group Chief Operating Officer and Executive Director

Age: 48

Appointed: 9 August 2010

Andrew is the Group Chief Operating Officer and is also responsible for the Group's finance function and for acquiring businesses into the Group. Prior to joining the Group, Andrew was with the Datatec Limited group in a number of roles between 2000 and 2009 including the Logicalis Group Operations Director and Corporate Finance and Strategy Director. He led the Logicalis acquisition strategy, acquiring and integrating 12 companies in the US, UK, Europe and South America. Prior to this, Andrew gained considerable corporate finance experience in London with Standard Bank, West Deutsche Landesbank and Coopers & Lybrand. He trained and qualified as a chartered accountant and has a bachelor's degree in commerce from the University of Natal, South Africa.

Richard Last

Non-executive Director

Age: 55

Appointed: 22 May 2008

Richard is Chairman of Arcontech Group, a provider of IT solutions for the financial services sector which is listed on AIM; Lighthouse Group plc, an AIM listed financial services group; and the British Smaller Technology Companies VCT 2 plc, a fully listed Venture Capital Trust. He is also Chairman of CSE Global (UK) Ltd which is a subsidiary of Singapore listed CSE Global Ltd of which he is a Non-executive director and is a director of a number of private businesses. Richard is a Fellow of the Institute of Chartered Accountants in England and Wales (FCA). Richard is chairman of the Corero Audit Committee.

Andrew Lloyd

Non-executive Director

Age: 47

Appointed: 19 November 2012

Andrew has been involved in the IT software and systems sector for more than 25 years. His career has included roles in early stage companies, high-growth pre-IPO ventures as well as large corporations such as Computer Associates and Oracle. Andrew is Senior Vice President of PRISMTECH Group's OpenSplice business which, through offices in Europe and North America, develops and markets performance-critical middleware software products for the military, aerospace, telecommunications, industrial and financial services markets. He is also a non-executive director of NetIDme Limited, a venture capital-backed provider of online age verification and identity authentication technology for a wide variety of industries including online gaming and gambling businesses. Andrew has a BSc (Hons), Electronic and Electrical Engineering from Heriot-Watt University, Scotland.

Duncan Swallow

Company Secretary

Age: 48

Appointed: 1 November 2007

Duncan is responsible for the Company secretarial function and is also the Group Financial Controller. Prior to joining the Company, Duncan was Divisional Financial Controller for CCH, a Wolters Kluwer business, specialising in providing books, online information, software, CPD and fee protection to tax and accounting professionals. He is a fellow of the Association of Chartered Certified Accountants.

Directors' Report

for the year ended 31 December 2012

Principal activities

The principal activity of the Group during the year ended 31 December 2012 was the supply of security products and services to international customers and the supply of finance and management information software solutions to the UK education and commercial markets.

A review of the Group's performance is disclosed within the Chairman's Statement and the Financial Review.

Business review

The information satisfying the business review requirements is set out in this report: the Chairman's Statement on pages 6 to 9; the Financial Review on pages 10 to 13; the review of the principal risks and uncertainties on pages 11 to 13; all of which are incorporated into this report by reference. The Corporate Governance report forms part of this Directors' report and is incorporated into it by reference.

Group results

The Group's Statement of Comprehensive Income on page 25 shows a loss for the year of $5.9 million (2011: $2.0 million).

Going concern

The financial position, cash flows and borrowing facilities are described in the Financial Review on pages 10 to 13.

Forecasts and projections, taking into account reasonably possible changes in trading performance, show that the Company and Group will be able to operate within the level of current cash balances and facilities.

The Directors are satisfied, in view of the cash reserves of $4.9 million (2011: $6.7 million) held on the balance sheet at 31 December 2012, and the $6.2 million (before costs) raised from the March 2013 share issue, that the Company and the Group have adequate resources to continue operating for the foreseeable future. For this reason the going concern basis has been adopted in preparing the accounts.

Dividends

The Directors have not recommended a dividend (2011: £nil).

Post balance sheet event

On 20 March 2013 the Company raised $6.2 million (£4.1 million) (before costs), of which the directors contributed $4.2 million (£2.8 million), by way of a placing of 27,000,004 new ordinary shares at a price of 15p per share, to support the investment in the Corero Network Security business' next generation product.

Share capital

The issued share capital of the Company together with details of movements in the Company's issued share capital during the financial period are shown in note 25 to the financial statements. As at the date of this report, 85,637,416 ordinary shares of 1p each ('ordinary shares') were in issue and fully paid with an aggregate nominal value of $1.3 million.

The market price of the ordinary shares at 31 December 2012 was 32.5p and the shares traded in the range 29.5p to 60.5p during the year.

Issue of shares

At the AGM held on 7 June 2012 shareholders granted authority to the Board under the Articles and section 551 of the Companies Act 2006 (the 'Act') to exercise all powers of the Company to allot relevant securities up to an aggregate nominal amount of £194,431. It is proposed at the forthcoming AGM to renew the authority to allot relevant securities up to an aggregate nominal amount of £285,458, being one-third of the nominal value of the current issued share capital.

Also at the AGM held on 7 June 2012, shareholders granted authority to the Board under the Articles and section 570(1) of the Act to exercise all powers of the Company to allot equity securities wholly for cash up to an aggregate nominal amount of £87,494 without application of the statutory pre-emption rights contained in section 561 (1) of the Act. It is proposed at the forthcoming AGM to renew the authority to allot relevant securities wholly for cash up to an aggregate nominal amount of £85,637 being 10% of the current nominal value of the issued share capital, without application of the statutory pre-emption rights.

Substantial shareholdings

The Company has been notified of the following holdings that are 3% or more of the Group's ordinary share capital as at 20 March 2013:

Ordinary shares of 1 pence each	Number	%
Jens Montanana*	33,943,687	39.6
Herald Investment Management	7,261,723	8.5
Andre Stewart**	6,039,023	7.1
Investec Wealth & Investment Limited	5,268,448	6.2
Blackrock, Inc	4,570,494	5.3
Legal & General Investment Management Limited	3,957,364	4.6
Octopus Investments Limited	2,749,697	3.2

* of which 20,936,545 are held in the name of JPM International Limited, which is wholly owned by Jens Montanana, and 9,000,000 are held in the name of The New Millennium Technology Trust of which Jens Montanana is a beneficiary.

** of which 5,731,023 are held in the name of BFG Investments Group Limited which is wholly owned by Andre Stewart.

Directors and directors' interests

The directors who served in office during the year and up to the date of this report and their interests in the Company's shares were as follows:

Ordinary shares held	20 March 2013 Number	%	31 December 2012 Number	%	31 December 2011 Number	%
Jens Montanana	33,943,687	39.6	15,943,687	27.9	12,828,571	26.9
Andrew Miller	723,255	0.8	623,255	1.1	600,000	1.3
Richard Last	1,066,667	1.3	400,000	0.7	221,619	0.5
Edward Forward (resigned 19 March 2012)	–	–	n/a	–	–	–
Stephen Graham (resigned 30 June 2012)	–	–	n/a	–	n/a	–
Andrew Lloyd (appointed 19 November 2012)	–	–	–	–	n/a	–

The biographical details of the current Directors of the Company are given on pages 14 and 15.

Jens Montanana, Andrew Miller and Richard Last hold share options, details of which are shown in note 30 to the Financial Statements.

Payment of suppliers

It is Group policy to agree and clearly communicate the terms of payment as part of the commercial arrangements negotiated with suppliers and then to pay according to those terms based upon the satisfactory completion of contractual obligations and timely receipt of an accurate invoice. The creditor days outstanding (based on the count back method) at 31 December 2012 was 28 days (2011: 29 days).

Environment

The Group's activities are primarily office based and as such the directors believe that there is no significant environmental impact arising from the Group's activities. No environmental performance indicators are therefore included within this report. The Group's environmental policy states: "We endeavour to recycle appropriate materials where possible and to efficiently use natural resources and energy supplies so as to minimise our environmental impact. We will comply with the relevant statutes and legislation. Furthermore employees are encouraged to be environmentally aware. Company cars are not provided."

Directors' Report continued

Research and development

The development of computer software is an integral part of the Group's business and the Group continues to develop its core software in response to user demand, and particularly the changing IT security threat landscape, and changes in software technology. During the year the Group enhanced its existing products and developed new products. A capital investment of $3.2 million (2011: $1.8 million) was made during the year. Amortisation of $1.0 million (2011: $0.3 million) was charged to the Statement of Comprehensive Income during the year.

Employees

The quality and commitment of the Group's employees has played a major role in the Group's business success. This has been demonstrated in many ways, including strong customer satisfaction, the development of new product offerings and the flexibility employees have shown in adapting to changing business requirements. The Group operates sales commission, incentive bonus plans and share option and incentive plans to provide incentives for achievements which add value to the business.

Charitable or political donations

No charitable donations were made during the year (2011: $1,600). No political donations were made during the year.

Annual General Meeting

The AGM will be held at the offices of FinnCap Ltd, 60 New Bond Street, London, EC2M 1JJ, on 13 June 2013 at 10.00 a.m. The notice convening the meeting is on page 62 together with details of the business to be considered.

Auditors

In so far as each director is aware:

- there is no relevant audit information of which the Company's auditors are unaware; and
- the directors have taken all the steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

A resolution to re-appoint BDO LLP for the ensuing year will be proposed at the AGM.

By order of the Board

Duncan Swallow

Company Secretary
25 March 2013

Corporate Governance Report

As an AIM listed company, Corero is not required to comply with the Corporate Governance Code prepared by the Committee on Corporate Governance, appended to the Listing Rules of the FSA, however, the Company has regard to the requirements of the Code and its activities in these areas are described below.

The Board

Corero recognises its responsibility to provide entrepreneurial and responsible leadership to the Group within a framework of prudent and effective controls (described below) allowing assessment and management of the key issues and risks impacting the business. The Board sets Corero's overall strategic direction, reviews management performance and ensures that the Group has the necessary financial and human resources in place to meet its objectives. The Board is satisfied that the necessary controls and resources exist within the Group to enable these responsibilities to be met.

Operational management of the Group is delegated to the Executive Director and Business unit heads who meet regularly to discuss such matters. These matters include product development and roadmap, sales, customer relationships and employee matters.

The Board of Directors comprises the non-executive chairman, one executive director and two non-executive directors whose Board and Committee responsibilities as at 31 December 2012 are set out below:

	Board	Audit	Remuneration
Jens Montanana	Chairman	Member	Chairman
Andrew Miller	Member		
Richard Last	Member	Chairman	Member
Andrew Lloyd	Member		Member

The composition of the Board of Directors is reviewed regularly. Appropriate training, briefings, and induction are available to all directors on appointment and subsequently as necessary, taking into account existing qualifications and experience.

Richard Last and Andrew Lloyd are considered to be independent.

Executive directors' normal retirement age is 60 and non-executive directors' normal retirement age is 65. One third of all directors are subject to annual reappointment by shareholders as well as any director appointed by the Board in the period since the last AGM. Jens Montanana, Andrew Miller and Andrew Lloyd (appointed 19 November 2012) will be offering themselves for re-election at the forthcoming AGM.

The Board of Directors meets on average once a quarter and additional meetings are held each year to review and approve the Group's strategy and financial plans for the coming year. Each director is provided with sufficient information to enable them to consider matters in good time for meetings and enable them to discharge their duties properly.

All directors have access to the advice and services of the Company Secretary. There is also a procedure in place for any director to take independent professional advice if necessary, at the Company's expense.

The Board also ensures that the principal goal of the Company is to create shareholder value, while having regard to other stakeholder interests and takes responsibility for setting the Company's values and standards.

Corporate Governance Report continued

There is a documented schedule of matters reserved for the Board, the most significant of which are:

- responsibility of the overall strategy and management of the Group;
- approval of strategic plans and budgets and any material changes to them;
- approval of the acquisition or disposal of subsidiaries and major investments, projects and contracts;
- oversight of the Group's operations ensuring competent and prudent management, sound planning and management of adequate accounting and other records;
- changes relating to the Group's capital structure;
- final approval of the annual and interim financial statements and accounting policies;
- approval of the dividend policy;
- ensuring an appropriate system of internal control and risk management is in place;
- approval of changes to the structure, size and composition of the Board;
- review of the management structure and senior management responsibilities;
- with the assistance of the Remuneration Committee, approval of remuneration policies across the Group;
- delegation of the Board's powers and authorities;
- consideration of the independence of the Non-executive Directors; and
- receiving reports on the views of the Company's shareholders.

In the year ended 31 December 2012 the Board received monthly briefings on the Group's performance (including detailed commentary and analysis), key issues and risks affecting the Group's business.

The Company maintains liability insurance for its directors and officers. The Company has also entered into indemnity agreements with the Directors, in terms of which the Company has indemnified its directors, subject to the Companies Act limitations, against any liability arising out of the exercise of the directors' powers, duties and responsibilities as a director or officer.

In the year ended 31 December 2012 the Board met on five scheduled occasions; further meetings and conference calls are held as and when necessary. Details of Directors' attendance at scheduled meetings in the year to 31 December 2012 is shown in the table below:

	Meetings attended
Jens Montanana	5/5
Andrew Miller	5/5
Richard Last	5/5
Edward Forwood (resigned 19 March 2012)	2/2
Stephen Graham (appointed 19 March 2012, resigned 30 June 2012)	1/1
Andrew Lloyd (appointed 19 November 2012)	1/1

Board Committees

The Company has an Audit Committee and Remuneration Committee, details of which are set out below.

Audit Committee

The Audit Committee members comprise Richard Last, who is the committee chairman, and Jens Montanana, and meets twice a year. The Group Financial Controller, Chief Operating Officer and the Company's external auditors attend the meetings. The Audit Committee considers the adequacy and effectiveness of the risk management and control systems of the Group. It reviews the scope and results of the external audit, its cost effectiveness and the objectivity of the auditors. It also reviews, prior to publication, the interims, preliminary announcement, the annual financial statements and the other information included in the annual report.

The Audit Committee met twice in the year ended 31 December 2012. The attendance of individual Committee members at Audit Committee meetings in the year to 31 December 2012 is shown in the table below:

	Meetings attended
Richard Last	2/2
Jens Montanana	2/2

Remuneration Committee

The Remuneration Committee comprises Jens Montanana, who is the committee chairman, Richard Last and Andrew Lloyd. It meets at least twice a year and reviews and advises upon the remuneration and benefits packages of the executive directors. The remuneration of the chairman and non-executive directors is decided upon by the Board of Directors.

The Remuneration Committee met twice times in the year ended 31 December 2012. The attendance of individual Committee members at Remuneration Committee meetings in the year to 31 December 2012 is shown in the table below:

	Meetings attended
Jens Montanana	2/2
Richard Last	2/2
Andrew Lloyd (appointed 19 November 2012)	–

Nominations Committee

Due to the size of the Board of Directors, the directors do not consider there to be any need for a nominations committee. Issues that would normally be dealt with by a nominations committee are handled by the Board of Directors. The Board of Directors will review the need for a nominations committee on a regular basis.

Internal controls

The directors are responsible for the Group's system of internal control and for reviewing its effectiveness whilst the role of management is to implement policies on risk management and control. The Group's system of internal control is designed to manage, rather than eliminate, the risk of failure to achieve the Group's business objectives and can only provide reasonable, and not absolute, assurance against material misstatement or loss.

The Board continually reviews the effectiveness of other internal controls, including financial, operational, compliance controls and risk management. There were no specific reports tabled during the year ended 31 December 2012.

The Group operates a risk management process, which is embedded in normal management and governance processes. As part of the annual strategic planning and budgeting process, each business unit documents the significant risks identified, the probability of those risks occurring, their potential impact and the plans for managing and mitigating each of those risks.

The Group operates a series of controls to meet its needs. These controls include, but are not limited to, the annual strategic planning and budgeting process, a clearly defined organisational structure with authorisation limits, reviews by senior management of monthly financial and operating information including comparisons with budgets, monthly treasury and cash flow reports and forecasts to the Board.

The Audit Committee receives reports from management and observations from the external auditors concerning the system of internal control and any material control weaknesses. Significant risk issues, if any, are referred to the Board of Directors for consideration.

The Board of Directors makes an annual assessment of the effectiveness of the Group's internal control system, including financial, operational and compliance controls, before making this statement. The Board of Directors also considers issues included in reports received during the year, how the risks have changed during the year and reviews any reports prepared on internal controls by management and any issues identified by external auditors.

The Board of Directors does not believe it is currently appropriate to establish a separate, independent internal audit function given the size of the Group.

Remuneration report

The Remuneration Committee's principal function is to set remuneration of the Group's executive directors and business unit heads to ensure they are fairly compensated.

Basic salaries are set to ensure high quality executive directors and management are attracted and retained by the Group. They reflect the knowledge, skill and experience of each individual director. Bonuses are non-pensionable and only payable if the Remuneration Committee assesses the director's achievements as worthy of the award.

The Remuneration Committee is also responsible for ensuring the Group's share option schemes are operated properly. Details of directors' share options at 31 December 2012 are disclosed in note 30 of the Financial Statements.

Details of directors' remuneration for the year ended 31 December 2012 are set out in note 27 of the Financial Statements. Jens Montanana has elected to waive the fees payable to him for the financial year ended 31 December 2012.

Andrew Miller, executive director, has a service agreement which is terminable by either party on not less than three months' written notice increasing by one month at the end of each complete 12 month period of continuous employment provided that the notice period shall not exceed six months in total. The agreement contains provisions for early termination in certain circumstances.

None of the Non-executive Directors has a service agreement. Letters of appointment for Jens Montanana, Richard Last and Andrew Lloyd are for 12 month terms and provide that the appointment may be terminated by either party giving to the other not less than three months notice.

Statement of Directors' Responsibilities

The directors are responsible for preparing the Annual Report and Financial Statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the Group and Company financial statements in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs). Under company law the directors must not approve the financial statements unless they give a true and fair view of the state of affairs of the Group and parent company and of the profit or loss of the Group for that period. The directors' are also required to prepare financial statements in accordance with the rules of the London Stock Exchange for companies trading securities on the AIM. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable IFRSs have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the financial position of the Group and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for ensuring the annual report and the financial statements are made available on a website. Financial statements are published on the Company's website in accordance with legislation in the United Kingdom governing the preparation and dissemination of financial statements, which may vary from legislation in other jurisdictions. The maintenance and integrity of the Company's website is the responsibility of the directors. The directors' responsibility also extends to the ongoing integrity of the financial statements contained therein.

Independent Auditor's Report

to the members of Corero Network Security plc

We have audited the financial statements of Corero Network Security plc for the year ended 31 December 2012 which comprise the consolidated statement of comprehensive income, the consolidated and company statements of financial position, the consolidated and company statements of cash flows, the consolidated and company statements of changes in equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As explained more fully in the statement of directors' responsibilities, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the group's and the parent company's affairs as at 31 December 2012 and of the group's loss for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion the information given in the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Gary Hanson (senior statutory auditor)

For and on behalf of BDO LLP, statutory auditor
Cambridge
United Kingdom
25 March 2013

BDO LLP is a limited liability partnership registered in England and Wales (with registered number OC305127).

Consolidated Statement of Comprehensive Income

for the year ended 31 December 2012

	Note	Total 2012 $'000	Total 2011 Restated $'000
Revenue		20,565	18,034
Cost of sales		(5,116)	(4,090)
Gross profit		15,449	13,944
Operating expenses before highlighted items		(18,554)	(13,501)
– Depreciation and amortisation of intangible assets	13,14,15	(2,767)	(1,521)
– Acquisition and restructuring costs		–	(975)
Operating expenses		(21,321)	(15,997)
Operating loss		(5,872)	(2,053)
Finance income	6	119	98
Finance costs	7	(507)	(359)
Loss before taxation		(6,260)	(2,314)
Taxation	9	371	308
Loss for the year		(5,889)	(2,006)
Other comprehensive income/(expense)			
Difference on translation of UK functional currency entities		537	(358)
Total comprehensive expense for the year		(5,352)	(2,364)
Total loss for the year attributable to:			
Equity holders of the parent		(6,055)	(2,051)
Non-controlling interest		166	45
		(5,889)	(2,006)
Total comprehensive expense for the year attributable to:			
Equity holders of the parent		(5,495)	(2,400)
Non-controlling interest		143	36
Total		(5,352)	(2,364)

Basic and diluted loss per share		2012 Cents	2011 Restated Cents
Basic and diluted loss per share	11	(9.7)	(5.3)

The notes on pages 31 to 61 form part of these financial statements.

Consolidated Statement of Financial Position

as at 31 December 2012

	Note	2012 $'000	2011 Restated $'000	2010 Restated $'000
Assets				
Non-current assets				
Goodwill	12	18,811	18,772	790
Acquired intangible assets	13	3,739	4,659	8
Capitalised development expenditure	14	4,528	2,325	917
Property, plant and equipment	15	1,241	1,015	56
		28,319	26,771	1,771
Current assets				
Inventories	17	622	373	–
Trade and other receivables – due in less than one year	18	4,442	5,059	1,271
Trade and other receivables – due in more than one year	18	1,123	245	3
Cash and cash equivalents		4,861	6,680	11,155
		11,048	12,357	12,429
Liabilities				
Current Liabilities				
Trade and other payables	19	(3,972)	(4,375)	(1,148)
Borrowings	20	(182)	(273)	–
Deferred income	22	(7,592)	(8,390)	(2,306)
		(11,746)	(13,038)	(3,454)
Net current (liabilities)/assets		(698)	(681)	8,975
Non-current liabilities				
Borrowings	20	(5,984)	(5,510)	–
Deferred income	22	(1,146)	(1,252)	–
Deferred taxation	23	(1,196)	(1,567)	–
		(8,326)	(8,329)	–
Net assets		19,295	17,761	10,746
Total equity attributable to owners of the parent				
Ordinary share capital	25	925	752	496
Deferred share capital	25	7,051	7,051	7,051
Shares to be issued		–	124	–
Share premium	26	38,046	31,228	22,262
Merger reserve		–	–	1,588
Share options reserve		268	259	226
Translation reserve		211	(349)	–
Retained earnings		(27,395)	(21,340)	(20,877)
		19,106	17,725	10,746
Non-controlling interest		189	36	–
Total equity		19,295	17,761	10,746

These financial statements were approved by the Board of Directors on 25 March 2013 and signed on their behalf.

Andrew Miller

Director

The notes on pages 31 to 61 form part of these financial statements.

Company Statement of Financial Position

as at 31 December 2012

	Note	2012 $'000	2011 Restated $'000	2010 Restated $'000
Assets				
Non-current assets				
Investments in subsidiaries	16	26,720	18,220	638
		26,720	18,220	638
Current assets				
Trade and other receivables – due in less than one year	18	–	3	99
Trade and other receivables – due in more than one year	18	8,407	6,159	4,415
Cash and cash equivalents		2,971	4,714	9,850
		11,378	10,876	14,364
Liabilities				
Current Liabilities				
Trade and other payables	19	–	–	(3)
		–	–	(3)
Net current assets		11,378	10,876	14,361
Net assets		38,098	29,096	14,999
Equity				
Ordinary share capital	25	925	752	496
Deferred share capital	25	7,051	7,051	7,051
Shares to be issued		–	124	–
Share premium	26	38,046	31,228	22,262
Merger reserve		–	–	1,588
Share options reserve		268	259	226
Translation reserve		1,171	(525)	–
Retained earnings		(9,363)	(9,793)	(16,624)
Total equity		38,098	29,096	14,999

These financial statements were approved by the Board of Directors on 25 March 2013 and signed on their behalf.

Andrew Miller

Director

The notes on pages 31 to 61 form part of these financial statements.

Statements of Cash Flows

for the year ended 31 December 2012

		Group		Company	
			2011		2011
		2012	Restated	2012	Restated
Cash flows from operating activities	**Note**	**$'000**	**$'000**	**$'000**	**$'000**
(Loss)/profit before taxation		(6,260)	(2,314)	430	5,243
Adjustments for:					
Amortisation of acquired intangible assets	13	1,157	924	–	–
Amortisation of capitalised development expenditure	14	1,044	322	–	–
Depreciation	15	566	275	–	–
Finance income	6	(119)	(98)	(443)	(151)
Finance expense	7	507	359	–	–
Decrease in provisions		–	(7)	–	–
Share based payment charge	30	9	32	9	32
Changes in working capital					
Increase in inventories		(233)	(151)	–	–
(Increase)/decrease in trade and other receivables		–	(2,776)	40	(349)
(Decrease)/increase in payables		(1,802)	1,864	–	(5,582)
Net cash from operating activities		(5,131)	(1,570)	36	(807)
Cash flows from investing activities					
Acquisition of subsidiaries, net of cash acquired	32	–	(3,649)	10	(3,649)
Purchase of intangible assets	13	(237)	(61)	–	–
Capitalised development expenditure	14	(3,174)	(1,754)	–	–
Purchase of property, plant and equipment	15	(802)	(976)	–	–
Repayments from subsidiaries		–	–	792	2,108
Payments made to subsidiaries		–	–	(9,774)	(6,176)
Net cash used in investing activities		(4,213)	(6,440)	(8,972)	(7,717)
Cash flows from financing activities					
Net proceeds from issue of ordinary share capital		6,989	3,403	6,868	3,403
Term loan received		250	250	–	–
Finance income	6	119	98	116	98
Finance expense		(64)	(17)	–	–
Repayment of term loans		(121)	–	–	–
Capital element of finance lease repayments		(27)	(22)	–	–
Repayment of credit facility		(189)	(300)	–	–
Net cash from financing activities		6,957	3,412	6,984	3,501
Effects of exchange rates on cash and cash equivalents		568	123	209	(113)
Net decrease in cash and cash equivalents		(1,819)	(4,475)	(1,743)	(5,136)
Cash and cash equivalents at 1 January		6,680	11,155	4,714	9,850
Cash and cash equivalents at 31 December		4,861	6,680	2,971	4,714

The notes on pages 31 to 61 form part of these financial statements.

Consolidated Statement of Changes in Equity

for the year ended 31 December 2012

	Share capital $'000	Shares to be issued $'000	Share premium account $'000	Merger reserve $'000	Share options reserve $'000	Translation reserve $'000	Retained earnings $'000	Total attributable to equity holders of the parent $'000	Non-controlling interest $'000	Total equity $'000
1 January 2011	7,547	–	22,262	1,588	226	–	(20,877)	10,746	–	10,746
Loss for the year	–	–	–	–	–	–	(2,051)	(2,051)	45	(2,006)
Other comprehensive expense	–	–	–	–	–	(349)	–	(349)	(9)	(358)
Total comprehensive expense for the year	–	–	–	–	–	(349)	(2,051)	(2,400)	36	(2,364)
Contributions by and distributions to owners										
Share based payments	–	–	–	–	33	–	–	33	–	33
Issue of share capital	256	–	8,966	–	–	–	–	9,222	–	9,222
Transfer	–	–	–	(1,588)	–	–	1,588	–	–	–
Shares to be issued	–	124	–	–	–	–	–	124	–	124
Total contributions by and distributions to owners	256	124	8,966	(1,588)	33	–	1,588	9,379	–	9,379
31 December 2011	7,803	124	31,228	–	259	(349)	(21,340)	17,725	36	17,761
Loss for the year	–	–	–	–	–	–	(6,055)	(6,055)	166	(5,889)
Other comprehensive income	–	–	–	–	–	560	–	560	(23)	537
Total comprehensive expense for the year	–	–	–	–	–	560	(6,055)	(5,495)	143	(5,352)
Contributions by and distributions to owners										
Share based payments	–	–	–	–	9	–	-	9	–	9
Issue of share capital	173	–	6,818	–	–	–	–	6,991	–	6,991
Shares to be issued	–	(124)	–	–	–	–	–	(124)	–	(124)
Dilution of ownership of subsidiary	–	–	–	–	–	–	–	–	10	10
Total contributions by and distributions to owners	173	(124)	6,818	–	9	–	–	6,876	10	6,886
31 December 2012	7,976	–	38,046	–	268	211	(27,395)	19,106	189	19,295

Amounts prior to 1 January 2012 have been restated as per note 1 to the Financial Statements.

The notes on pages 31 to 61 form part of these financial statements.

Company Statement of Changes in Equity

for the year ended 31 December 2012

	Share capital $'000	Shares to be issued $'000	Share premium account $'000	Merger reserve $'000	Share options reserve $'000	Translation reserve $'000	Retained earnings $'000	Total equity $'000
1 January 2011	7,547	–	22,262	1,588	226	–	(16,624)	14,999
Profit for the year	–	–	–	–	–	–	5,243	5,243
Other comprehensive income	–	–	–	–	–	(525)	–	(525)
Total comprehensive income for the year	–	–	–	–	–	(525)	5,243	4,718
Contributions by and distributions to owners								
Share based payments	–	–	–	–	33	–	–	33
Issue of share capital	256	–	8,966	–	–	–	–	9,222
Transfer	–	–	–	(1,588)	–	–	1,588	–
Shares to be issued	–	124	–	–	–	–	–	124
Total contributions by and distributions to owners	256	124	8,966	(1,588)	33	–	1,588	9,379
31 December 2011	7,803	124	31,228	–	259	(525)	(9,793)	29,096
Profit for the year	–	–	–	–	–	–	430	430
Other comprehensive income	–	–	–	–	–	1,696	–	1,696
Total comprehensive income for the year	–	–	–	–	–	1,696	430	2,126
Contributions by and distributions to owners								
Share based payments	–	–	–	–	9	–	–	9
Issue of share capital	173	–	6,818	–	–	–	–	6,991
Shares to be issued	–	(124)	–	–	–	–	–	(124)
Total contributions by and distributions to owners	173	(124)	6,818	–	9	–	–	6,876
31 December 2012	7,976	–	38,046	–	268	1,171	(9,363)	38,098

Amounts prior to 1 January 2012 have been restated as per note 1 to the Financial Statements.

Under the terms of the Top Layer Networks, Inc. acquisition (which has since been renamed Corero Network Security, Inc.), deferred consideration of $123,558 payable to the management of Top Layer, was to be satisfied by the issue of 177,145 new ordinary shares in the Company to be issued on 2 September 2012 subject to adjustment for set off against any warranty claims brought by the Company in accordance with the terms of the acquisition agreement. The Company made a cash payment in September 2012 of $105,000 (net of a set-off of $7,500 for warranty claims) to satisfy the deferred consideration obligation.

The notes on pages 31 to 61 form part of these financial statements.

Notes to the Financial Statements

1. General information

Presentation currency

Subsequent to the acquisition and integration of the US based Corero Network Security division (formerly Top Layer Networks) during 2011, the Group's reporting currency has been changed to US Dollars ("$") which is more closely aligned to the profile of the Group's revenue and cost base. The change is effective from 1 January 2012 and thus the results for the 12 months ended 31 December 2012 are reported in $. The average $-GBP sterling ("GBP") exchange rate, used for the conversion of the statement of comprehensive income, for the 12 months ended 31 December 2012 was 1.59 (2011: 1.60). The closing $-GBP exchange rate, used for the conversion of the Group's assets and liabilities, at 31 December 2012 was 1.63 (2011: 1.55, 2010: 1.55).

Restatement of comparatives

Values in the primary statements and notes 5 to 32 relating to the periods prior to 1 January 2012 have been restated from GBP to $.

Corero Network Security plc is a public limited company incorporated in the United Kingdom under the Companies Act 2006.

2. Significant accounting policies

2.1 Basis of preparation

The Group and parent Company financial statements have been prepared in accordance with EU endorsed International Financial Reporting Standards (IFRS), International Financial Reporting Interpretations Committee (IFRIC) interpretations and those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

2.2 Going Concern

The financial statements have been prepared on a going concern basis. The Group was loss making and used cash in operating activities during the year.

The directors have prepared detailed income statement, balance sheet and cash flow projections for the period to 31 December 2014. The cash flow projections have been subjected to sensitivity analysis at the revenue, cost and combined revenue and cost levels. The cash flow projections show that the Group will maintain a positive cash balance until at least 31 December 2014 on the assumption that the 8% Loan Notes (see note 20) which are due for repayment in March 2014 will be refinanced.

As a result, the directors are of the opinion that the Group has adequate working capital to continue as a going concern for the foreseeable future and, in particular, for a period of at least 12 months from the date of approval of these financial statements.

2.3 Basis of consolidation

The consolidated financial statements incorporate the results, assets, liabilities and cash flows of the Company and each of its subsidiaries for the financial year ended 31 December 2012.

Subsidiaries are entities controlled by the Group. Control is deemed to exist when the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The results, assets, liabilities and cash flows of subsidiaries are included in the consolidated financial statements from the date control commences until the date that control ceases.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group.

The merger reserve which was transferred to retained earnings in the prior year related to a realised investment in a former division of a subsidiary undertaking.

Intra-group balances and transactions are eliminated on consolidation.

2.4 Business combinations

The acquisition method is used to account for all acquisitions. The cost of an acquisition is measured at the fair values, on the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued.

At the date of acquisition, the identifiable assets and liabilities and contingent liabilities of a subsidiary are measured at their fair values. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill.

Non-controlling interests are initially recognized at their fair value. The total comprehensive income of non-wholly owned subsidiaries is attributed to owners of the parent and to the non-controlling interests in proportion to their relative ownership interests.

2.5 Revenue

Revenue is measured at the fair value of the consideration received or receivable and represents the amounts receivable for services provided in the normal course of business, net of all related discounts and sales tax.

Notes to the Financial Statements continued

The Group has adopted the following policy in respect of revenue recognition:

1. Software Products

Revenue results mainly from the sale of licences, which provide customers with the right to use these products. Such revenue is recognised on the following basis:

i. If an arrangement to deliver software or a software system, either alone or together with other products or services, requires significant production, modification, or customisation, the revenue for both services and software is recognised under the percentage of completion method.

ii. If services are essential to the functionality of the software and the payment terms are linked, the revenue for both software and services is recognised when the following conditions are met:

– A signed contract exists;

– Delivery has occurred;

– The sales price is fixed and determinable;

– Collection of the debt is probable;

– No significant obligations remain.

iii. If services are incidental to the functionality and/or the payment terms are linked to installations, revenue from the grant of perpetual or fixed term licences to use Corero's software products revenue is recognised when the above conditions are met and services revenue is recognised separately as the services are provided. Where services are not incidental to the functionality, licence revenues are recorded as agreed project milestones are achieved.

2. Hardware and Software Products

When a sales arrangement contains multiple elements, such as hardware and software products, licenses and/or services, the Group allocates revenue to each element based on a selling price hierarchy, having evaluated each deliverable in an arrangement to determine whether they represent separate units of accounting. A deliverable constitutes a separate unit of accounting when it has standalone value.

The selling price for a deliverable is based on its vendor specific objective evidence ("VSOE") if available, third party evidence ("TPE") if VSOE is not available, or best estimated selling price ("BESP") if neither VSOE nor TPE is available. In multiple element arrangements where more-than-incidental software deliverables are included, revenue is allocated to each separate unit, accounting for each of the non-software deliverables and to the software deliverables as a group using the relative selling prices of each of the deliverables in the arrangement based on the aforementioned selling price hierarchy.

The Group establishes the VSOE of selling price using the price charged for a deliverable when sold separately. The TPE of selling price is established by evaluating similar and interchangeable competitor products or services in standalone sales to similarly situated customers. The best estimate of selling price is established considering both internal and external factors such as pricing practices, customer pricing strategies, margin objectives, market conditions, competitor pricing strategies, and industry technology lifecycles.

3. Consulting and Professional Services

Revenue from the provision of consultancy and professional services is recognised as the work is performed.

4. Support income

Support income is recognised on a straight line basis over the life of the agreement.

2.6 Cost of sales

Cost of sales includes all direct costs associated with revenue generation, including services delivery, support costs and amounts charged by external third parties for services and goods directly related to revenue. Examples of such costs would include, but not be limited to, external consultants and third party hardware and software costs.

2.7 Foreign currencies

Transactions in foreign currencies are translated at the exchange rate ruling at the date of each transaction. Foreign currency monetary assets and liabilities are retranslated using the exchange rates at the reporting date. Gains and losses arising from changes in exchange rates after the date of the transaction are recognised in profit or loss in the Statement of Comprehensive Income.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated at the exchange rate at the date of the original transaction.

In the consolidated financial statements, the net assets of the Group's UK operations are translated at the exchange rate at the reporting date. Income and expense items are translated at the average exchange rates for the period. The resulting exchange differences are recognised in the translation reserve. Such translation differences are recognised in profit or loss on the disposal of the UK operation.

2.8 Intangible assets

Internally generated intangible assets

The Group's internally generated intangible asset relates to its development expenditure.

Development expenditure is capitalised only when it is probable that future economic benefit will result from the project and the following criteria are met:

- The technical feasibility of the product has been ascertained;
- Adequate, technical, financial and other resources are available to complete and sell or use the intangible asset;
- The Group can demonstrate how the intangible asset will generate future economic benefits and the ability to use or sell the intangible asset can be demonstrated;
- It is the intention of management to complete the intangible asset and use it or sell it; and
- The development costs can be measured reliably.

Expenditure not meeting these criteria is expensed in the Statement of Comprehensive Income.

After initial recognition, internally generated intangible assets are carried at cost less accumulated amortisation and any impairment losses.

Acquired intangible assets

Purchased computer software is carried at cost less accumulated amortisation and any impairment losses.

Customer contracts and the related customer relationships are carried at cost less accumulated amortisation and any impairment losses.

Identifiable intangible assets acquired as part of a business combination are initially recognised separately from goodwill, irrespective of whether the assets have been recognised by the acquiree before the business combination. An intangible asset is considered identifiable only if it is separable or if it arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

Intangible assets acquired as part of a business combination and recognised by the Group are computer software, customer contracts and the related customer relationships.

After initial recognition, assets acquired as part of a business combination are carried at cost less accumulated amortisation and any impairment losses.

Amortisation

Intangible assets are amortised on a straight line basis, to reduce their carrying value to zero over their estimated useful lives. The following useful lives were applied during the year:

- Computer software acquired – 3 or 5 years straight line
- Customer contracts and the related customer relationships – 7 years straight line
- Capitalised development expenditure – 5 years straight line

Amortisation costs are included within operating expenses in the Statement of Comprehensive Income.

Methods of amortisation and useful lives are reviewed, and if necessary adjusted, at each reporting date.

2.9 Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and any impairment losses. Cost comprises the purchase cost of property, plant and equipment together with any directly attributable costs.

Subsequent costs are included in an asset's carrying value or are recognised as a separate asset when it is probable that future economic benefits associated with the additional expenditure will flow to the Group and the cost of the item can be measured reliably. All other costs are charged to the Statement of Comprehensive Income as incurred.

Depreciation commences when an asset is available for use. Depreciation is calculated so as to write off the cost or value of an asset, net of anticipated disposal proceeds, over the useful life of that asset as follows:

- Leasehold improvements – Period of the lease straight line
- Computer equipment – 2 to 4 years straight line
- Fixtures and fittings – 2 to 5 years straight line
- Office equipment – 3 to 5 years straight line

Methods of depreciation, residual values and useful lives are reviewed, and if necessary adjusted, at each balance sheet date.

The gain or loss arising from the disposal or retirement of an item of property, plant and equipment is determined as the difference between the net disposal proceeds and the carrying amount of the item, and is included in the Statement of Comprehensive Income.

Notes to the Financial Statements continued

2.10 Inventory

Inventory is stated at the lower of cost or net realisable value. Cost is computed using standard cost, which approximates actual cost, on a first-in, first-out basis. Rapid technological change and new product introductions and enhancements could result in excess or obsolete inventory. To minimise this risk, the Group evaluates inventory levels and expected usage on a periodic basis and records valuation allowances as required.

2.11 Impairment

At each reporting date, the Group assesses whether there is any indication that its assets have been impaired. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of any impairment. If it is not possible to estimate the recoverable amount of the individual asset, the recoverable amount of the cash-generating unit to which the asset belongs is determined.

The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs to sell and its value in use. The value in use is the present value of the future cash flows expected to be derived from an asset or cash-generating unit. This present value is discounted using a pre-tax rate that reflects current market assessments of the time value of money and of the risks specific to the asset for which future cash flow estimates have not been adjusted. If the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. That reduction is recognised as an impairment loss.

An impairment loss relating to assets carried at cost less any accumulated depreciation or amortisation is recognised immediately in the Statement of Comprehensive Income.

Goodwill acquired in a business combination is, from the acquisition date, allocated to each of the cash-generating units or groups of cash-generating units that are expected to benefit from the synergies of the combination.

Goodwill is tested for impairment at least annually, and whenever there is an indication that the asset may be impaired.

An impairment loss is recognised for cash-generating units if the recoverable amount of the unit is less than the carrying amount of the unit. The impairment loss is allocated to reduce the carrying amount of the assets of the unit by first reducing the carrying amount of any goodwill allocated to the cash-generating unit, and then reducing the carrying amounts of the other assets of the unit pro rata.

If an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount but limited to the carrying amount that would have been determined had no impairment loss been recognised in prior years. A reversal of an impairment loss is recognised in the Statement of Comprehensive Income. Impairment losses on goodwill are not subsequently reversed.

2.12 Borrowing costs

All borrowing costs directly attributable to a qualifying asset are capitalised as part of the cost of the asset.

2.13 Leases

Where substantially all of the risks and rewards incidental to ownership of a leased asset are transferred to the Company (a "finance lease"), the asset is treated as if it had been purchased outright. The amount initially recognised as an asset is the lower of the fair value of the leased property and the present value of the minimum lease payments payable over the term of the lease. The corresponding lease commitment is shown as a liability. Lease payments are analysed between capital and interest. The interest element is charged to the Statement of Comprehensive Income over the period of the lease and is calculated so that it represents a constant proportion of the lease liability. The capital element reduces the balance owed to the lessor.

Where substantially all of the risks and rewards incidental to ownership are not transferred to the Company (an "operating lease"), the total rentals payable under the lease are charged to the Statement of Comprehensive Income on a straight-line basis over the lease term. The aggregate benefit of lease incentives is recognised as a reduction of the rental expense over the lease term on a straight-line basis.

2.14 Investments in subsidiaries

In the Company's separate financial statements, investments in subsidiaries are carried at cost less any impairment provisions.

2.15 Taxation

The tax expense represents the sum of current tax and deferred tax.

Current tax

Current tax is based on taxable profit for the year and is calculated using tax rates enacted or substantively enacted at the reporting date. Taxable profit differs from accounting profit either because items are taxable or deductible in periods different to those in which they are recognised in the financial statements, or because they are never taxable or deductible.

Deferred tax

Deferred tax on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes is accounted for using the balance sheet liability method.

Using the balance sheet liability method, deferred tax liabilities are recognised in full for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. However, if the temporary difference arises from the initial recognition of goodwill or the initial recognition of an asset or liability in a transaction other than a business combination, that at the time of the transaction affects neither accounting nor taxable profit, it is not recognised as deferred tax asset or liability.

Deferred taxation is measured at the tax rates that are expected to apply when the asset is realised, or the liability settled, based on tax rates and laws enacted or substantively enacted at the reporting date.

2.16 Provisions

A provision is recognised when, as a result of a past event, the Group has a legal or constructive obligation, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of such an obligation can be made.

Provisions are measured at the best estimate of the expenditure required to settle the obligation at the reporting date. When the effect is material, the expected future cash flows required to settle the obligation are discounted at the pre-tax rate that reflects the current market assessments of the time value of money and the risks specific to the obligation.

2.17 Post-retirement benefits

The Group operates defined contribution group personal pension plans under which it is required to pay fixed contributions to separate funds controlled by trustees. Contributions to the schemes are based on a proportion of the employees' earnings and are charged to the Statement of Comprehensive Income when incurred. The Group has no obligation to the scheme beyond these contributions.

2.18 Financial instruments

The Group classifies financial instruments, or their component parts, on initial recognition as a financial asset, a financial liability or an equity instrument in accordance with the substance of the contractual arrangement.

Financial assets and financial liabilities are recognised in the Group's statement of financial position when the Group becomes party to the contractual provisions of the instrument.

The particular recognition and measurement methods adopted for the Group's financial instruments are disclosed below:

Trade and other receivables

Trade and other receivables are stated at their fair value at time of initial recognition, reflecting where material the time value of money. A provision for impairment of trade receivables is established when there is evidence that the Group will not be able to collect all amounts due according to the original terms of these receivables. The amount of the provision is the difference between the carrying value and the present value of estimated future cash flows, discounted at the original effective interest rate.

Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits on call with banks and bank overdrafts. Bank overdrafts are disclosed as current borrowings in the statement of financial position.

Trade and other payables

Trade and other payables are not interest bearing and are stated at their fair value at time of initial recognition. Thereafter they are accounted for at amortised cost.

2.19 Equity instruments

An equity instrument is any contract that evidences a residual interest in the assets of the Company after deducting all its liabilities. Equity instruments issued by the Company are recorded at the proceeds received, net of directly attributable issue cost.

2.20 Employee share option schemes

The Group operates an equity-settled share-based compensation plan. The fair value of the employees' services received in exchange for the grant of share options is measured at grant date and recognised as an expense on a straight line basis over the vesting period, based on the Group's estimate of shares that will eventually vest. Fair value is determined by reference to the Black Scholes option pricing model.

At each reporting date, the Group revises its estimate of the number of options that are expected to become exercisable.

Notes to the Financial Statements continued

When share options are exercised, the proceeds received, net of any transaction costs, are credited to share capital (nominal value) and share premium.

2.21 Invoice discounting

The group makes use of an invoice discounting facility to fund certain of its operations. Trade receivables are recognised as the Group retains the significant risks and benefits. The related funding is shown as a financial liability and accounted for on an amortised cost basis.

2.22 Standards and Interpretations not yet effective

The standards and interpretations that are issued but not yet effective at the date of authorisation of these financial statements are those that the Group reasonably expects will have an impact on disclosures, financial position or performance when applied at a future date. The Group intends to adopt these standards and interpretations, if applicable, when they become effective.

IAS 1 Presentation of Items of Other Comprehensive Income – Amendments to IAS 1

The amendments to IAS 1 change the grouping of items presented in other comprehensive income (OCI). Items that could be reclassified (or recycled) to profit or loss at a future point in time would be presented separately from items that will never be reclassified. The amendment affects presentation only and therefore has no impact on the Group's financial position or performance.

The amendments to IAS 1 are effective for annual periods beginning on or after 1 July 2012.

IFRS 10 Consolidated Financial Statements

IFRS 10 establishes a single control model that applies to all entities including structured entities (previously referred to as special purpose entities). The changes introduced by IFRS 10 will require management to exercise significant judgement to determine which entities are controlled and therefore are required to be consolidated by a parent, compared with the requirements that were in IAS 27. IFRS 10 is not expected to have any impact on the investments currently held within the Group.

This standard is effective for annual periods beginning on or after 1 January 2013.

IFRS 12 Disclosure of Interests in Other Entities

These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required, but will have no impact on the Group's financial position or performance.

This standard is effective for annual periods beginning on or after 1 January 2013.

3. Critical accounting judgements and key sources of estimation uncertainty

3.1 Critical judgements in applying the Group's accounting policies

In the process of applying the Group accounting policies, the following judgements have had a significant effect on the amounts recognised in the financial statements:

Internally generated research and development costs

Management monitors progress of internal research and development projects. Judgement is required in distinguishing the research phase from the development phase. Development costs are recognised as an asset when all criteria are met, whereas research costs are expensed as incurred. Management monitors whether the recognition requirements for development costs continue to be met. This is necessary as the economic success of any product development is uncertain.

3.2 Key accounting estimates and assumptions

Key assumptions concerning the future and other key sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are as follows:

Impairment of intangible assets and property, plant and equipment

The Group tests goodwill at least annually for impairment, and whenever there is an indication that the asset may be impaired. All other intangible assets and property, plant and equipment are tested for impairment when indicators of impairment exist. Impairment is determined with reference to the higher of fair value less costs to sell and value in use. Value in use is estimated using discounted future cash flows. Significant assumptions are made in estimating future cash flows about future events including future market conditions, future growth rates and apporpriate discount rates. Changes in these assumptions could affect the outcome of impairment reviews. Changes in these assumptions could affect the outcome of impairment reviews. Details of the main assumptions used in the assessment of the carrying value of the Group's cash generating units are set out in note 12.

Impairment of investments and intercompany balances (applies to the Company Financial Statements only)

The directors have reviewed the carrying value of the intercompany balances and cost of investments in subsidiaries of the Company with reference to current and future trading conditions. The investment and intercompany balance between the Company and Corero Business Systems Limited has been reviewed by reference to a valuation based on a multiple of the 2012 profit which the directors consider to be an appropriate valuation method.

The investment and intercompany balances between the Company and Corero Network Security, Inc. and

Corero Network Security (UK) Limited have been reviewed with reference to a valuation based on a discounted free cash flow which the directors consider to be an appropriate valuation methodology, in conjunction with the goodwill impairment review.

Going Concern

The directors have reviewed the future profit and cash flow projections in conjunction with the current economic climate in order to express an opinion on the adequacy of working capital and the ability to continue as a going concern for the foreseeable future. The methodology and uncertainties contained in the projections are detailed in the note 2.2.

4. Financial risk management

Capital management

The Group monitors its available capital, which it considers to be all components of equity other than amounts reflecting non-controlling interests, against its expected requirements.

The Group's objectives when maintaining capital are to safeguard the entity's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders, and to ensure that sufficient funds can be raised for investing activities. In order to maintain or adjust the capital structure, the Group may return capital to shareholders, issue new shares, or sell assets to reduce debt. The Group does not review its capital requirements according to any specified targets or ratios.

Treasury management

Group treasury policies are reviewed and approved by the Board. The objectives of Group treasury policies are to ensure that adequate financial resources are available for development of the business while at the same time managing financial risks. Financial instruments are used to reduce financial risk exposures arising from the Group's business activities and not for speculative purposes.

The Group's treasury activities are managed by the Group finance function under the direction of the Group Financial Controller. The Group Financial Controller reports to the Board on the implementation of Group treasury policy.

The Group's business activities expose it to a variety of financial risks. The policies for managing these risks are described below:

Liquidity risk

Liquidity risk is the risk that arises from the Group's management of working capital and finance charges. It is the risk that the Group will encounter difficulty in meetings its financial obligations as they fall due. Liquidity risk is managed centrally by the finance function. Budgets are set locally and centrally, and agreed by the Board annually in advance, enabling the Group's cash flow requirements to be anticipated.

Credit risk

Credit risk arises from cash and cash equivalents and from credit exposures to the Group's customers including outstanding receivables and committed transactions. Credit risk is managed with regular reports of exposures reviewed by management. The Group does not set individual credit limits but will seek to ensure that customers enter into legally enforceable contracts that include settlement terms that demonstrate the customers' commitment to the transaction and minimise this risk exposure.

The amounts of trade receivables presented in the Statement of Financial Position are shown net of allowances for doubtful accounts estimated by management based on prior experience and their assessment of the current economic environment (note 18).

The credit risk on liquid funds and financial instruments is limited because the counterparties are banks with acceptable credit ratings assigned by international credit rating agencies.

The Group has no significant concentration of credit risk, with exposure spread over a large number of customers.

Cash flow interest rate risk

The Group's policy is to minimise interest rate cash flow risk exposure on its financing. The majority of the Group's financing is held in fixed rate loans therefore no analysis of interest rate sensitivity is presented.

The Group's policy is to balance the risk in relation to cash balances held by spreading these across a number of financial institutions as opposed to maximising interest income.

Currency risk

There is no material impact on the Group's Statement of Comprehensive Income from exchange rate movements, as foreign currency transactions are entered into by Group companies whose functional currency is aligned with the currencies in which it transacts.

5. Segment reporting

Business segments

The Group is managed according to two business units which make up the Group's two reportable operating segments: Corero Network Security and Corero Business Systems. These divisions are the basis on which the Group reports its primary segment information to the Board, which management consider to be the Chief Operating Decision maker for the purposes of IFRS 8 Operating Segments. The principal activity of Corero Network Security is the design, development and delivery of network security products. The principal activity of Corero Business Systems is the design, development and delivery of finance and management information software to the school, further education and commercial sectors.

Central costs comprise mainly central and parent company overheads relating to the group management, the finance function and regulatory requirements.

	Reportable Operating Segments				Unallocated Items			
	Network Security		Business Systems		Central Costs		Total	
	2012 $'000	2011 $'000	2012 $'000	2011 $'000	2012 $'000	2011 $'000	2012 $'000	2011 $'000
Revenue to external customers								
Product and licence	4,437	4,845	3,207	1,978	–	–	7,644	6,823
Professional services	215	272	2,545	2,030	–	–	2,760	2,302
Support	6,726	5,871	3,435	3,038	–	–	10,161	8,909
Total	11,378	10,988	9,187	7,046	–	–	20,565	18,034
Cost of sales	(3,171)	(2,716)	(1,945)	(1,374)	–	–	(5,116)	(4,090)
Gross profit	8,207	8,272	7,242	5,672	–	–	15,449	13,944
Operating expenses before depreciation, amortisation, acquisition and restructuring costs	(13,190)	(9,181)	(4,125)	(3,121)	(1,239)	(1,199)	(18,554)	(13,501)
Depreciation and amortisation of intangible assets	(2,399)	(1,171)	(368)	(344)	–	(6)	(2,767)	(1,521)
Acquisition and restructuring costs	–	(485)	–	–	–	(490)	–	(975)
Operating expenses	(15,589)	(10,837)	(4,493)	(3,465)	(1,239)	(1,695)	(21,321)	(15,997)
Operating (loss)/profit	(7,382)	(2,565)	2,749	2,207	(1,239)	(1,695)	(5,872)	(2,053)
Finance income	–	–	3	–	116	98	119	98
Finance costs	(507)	(359)	–	–		–	(507)	(359)
(Loss)/profit before taxation	(7,889)	(2,924)	2,752	2,207	(1,123)	(1,597)	(6,260)	(2,314)

	Reportable Operating Segments				Unallocated Items			
	Network Security		Business Systems		Central Costs		Total	
	2012 $'000	2011 $'000	2012 $'000	2011 $'000	2012 $'000	2011 $'000	2012 $'000	2011 $'000
Non-current assets								
Goodwill	17,983	17,983	828	789	–	–	18,811	18,772
Acquired intangible assets	3,734	4,652	5	7	–	–	3,739	4,659
Capitalised development expenditure	2,662	998	1,866	1,327	–	–	4,528	2,325
Property, plant & equipment	1,095	928	146	87	–	–	1,241	1,015
	25,474	24,561	2,845	2,210	–	–	28,319	26,771
Current assets								
Inventories	622	373	–	–	–	–	622	373
Trade and other receivables	2,354	3,676	3,083	1,487	128	141	5,565	5,304
Cash and cash equivalents	689	714	1,107	812	3,065	5,154	4,861	6,680
	3,665	4,763	4,190	2,299	3,193	5,295	11,048	12,357
Current liabilities								
Trade and other payables	(1,853)	(2,877)	(1,787)	(1,369)	(332)	(129)	(3,972)	(4,375)
Borrowings	(182)	(273)	–	–	–	–	(182)	(273)
Deferred income	(4,057)	(5,238)	(3,535)	(3,152)	–	–	(7,592)	(8,390)
	(6,092)	(8,388)	(5,322)	(4,521)	(332)	(129)	(11,746)	(13,038)
Net current (liabilities)/assets	(2,427)	(3,625)	(1,132)	(2,222)	2,861	5,166	(698)	(681)
Non-current liabilities								
Borrowings	(5,984)	(5,510)	–	–	–	–	(5,984)	(5,510)
Deferred income	(1,146)	(1,252)	–	–	–	–	(1,146)	(1,252)
Deferred taxation	(1,196)	(1,567)	–	–	–	–	(1,196)	(1,567)
	(8,326)	(8,329)	–	–	–	–	(8,326)	(8,329)
Net assets/(liabilities)	14,721	12,607	1,713	(12)	2,861	5,166	19,295	17,761

Notes to the Financial Statements continued

The Group's revenues from external customers and its non-current assets are divided into the following geographical areas:

Geographical area	2012 $'000 Revenue	2012 $'000 Non-current assets	2011 $'000 Revenue	2011 $'000 Non-current assets
North America	5,736	25,474	5,885	24,561
EMEA	13,078	2,845	10,645	2,210
APAC	1,597	–	1,293	–
Other countries	154	–	211	–
Total	20,565	28,319	18,034	26,771

EMEA revenue analysis

	2012 $'000	2011 $'000
UK	11,338	8,913
Europe	1,740	1,732
Total	13,078	10,645

Revenues from external customers in the Group's domicile, United Kingdom, as well as its major markets have been identified on the basis of invoicing systems for the Corero Business Systems division. Revenues for external customers for the Corero Network Security division are identified on the basis of invoicing systems and adjusted to take into account the difference between invoiced amounts and deferred revenue adjustments required by IAS.

The Group's revenue is analysed as follows for each revenue category:

	2012 $'000	2011 $'000
Licence revenue	7,644	6,823
Professional services revenue	2,760	2,302
Support revenue	10,161	8,909
Total	20,565	18,034

6. Finance income

	2012 $'000	2011 $'000
Interest on bank deposits	119	98

7. Finance costs

	2012 $'000	2011 $'000
8% Loan Note interest payable	443	343
Bank interest payable (accounts receivable financing facility and term loan)	51	12
Finance interest	6	4
Other	7	–
	507	359

8. Loss for the year

The following items have been included in arriving at the loss for the year before taxation:

	2012 $'000	2011 $'000
Amortisation of acquired intangible assets (note 13)	1,157	924
Amortisation of capitalised development (note 14)	662	322
Impairment of capitalised development (note 14)	382	–
Research and development cost	3,119	2,223
Depreciation of property, plant and equipment (note 15)	566	275
Operating lease rentals payable	441	343
Trade receivables impairment	–	(6)

Auditor's remuneration

	2012 $'000	2011 $'000
Remuneration received by the Company's auditors or an associate of the Company's auditor for the audit of these Financial Statements	33	16
The audit of the accounts of other group companies	73	74
Fees payable to the Company's auditor for corporate finance services	5	214
Fees payable to the Company's auditor for taxation compliance services	24	24
Fees payable to the Company's auditor for taxation advisory services	25	47
	160	375

Notes to the Financial Statements continued

9. Tax on loss on ordinary activities

	2012 $'000	2011 $'000
Deferred tax credit for the year	371	308

The tax assessed on the loss on ordinary activities for the year differs from the weighted average UK corporate rate of tax of 24.5% (2011: 26.5%). The differences are reconciled below:

	2012	2011
Total tax reconciliation		
Loss before taxation	(6,260)	(2,314)
Theoretical tax credit at UK Corporation tax rate 24.5% (2011: 26.5%)	(1,534)	(613)
Effect of:		
– expenditure that is not tax deductible	198	401
– R&D tax credits	(934)	–
– accelerated capital allowances	(10)	(18)
– other timing differences	1	2
– relief for losses brought forward	(268)	(481)
– losses not utilised	2,547	709
– deferred tax credit	371	308
Actual taxation credit	371	308

Factors Affecting Future Tax Charges

As at 31 December 2012, the Group's cumulative fixed asset timing differences were $24,000 (2011: $86,000) and no deferred tax asset has been recognised in respect of these items.

In addition, the tax losses at that date amounted to $37.7 million (2011: $31.4 million). This comprised UK tax losses of $10.0 million and US tax losses of $27.7 million. $4.2 million of the tax losses relate to US capitalised R&D deductions which will be available at an accelerated level for 4 years. $9.0 million of the tax losses relate to pre-acquisition US tax losses which can be offset against taxable profits over 19 years (there is a limit on the utilisation of pre-acquisition tax losses of $0.7 million per annum and any unused loss may be carried forward to subsequent periods). All other US tax losses will expire in 20 years from the end of the accounting period in which the loss arose.

The deferred tax asset at a rate 23% of $1.9 million (2011: $1.9 million) relating to the UK tax losses (after offsetting the deferred tax liability of $0.4 million (2011: $0.3 million) relating to capitalised research and development expenditure) and the deferred tax asset at a rate of 35% of $9.7 million (2011: $7.7 million) relating to the US tax losses have not been recognised due to uncertainties as to the extent and timing of their future recovery.

10. Profit of the parent Company for the financial year

The Company has taken advantage of section 408 of the Companies Act 2006 and has not included an income statement in these financial statements. The parent Company's profit for the year was $430,000 (2011: $6,831,000).

11. Loss per share

Loss per share is calculated by dividing the earnings attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares in issue during the year.

At the reporting dates there were no potentially dilutive ordinary shares. Therefore the diluted loss per share is equal to the loss per share.

	2012 loss $'000	2012 weighted average number of 1p shares Thousand	2012 loss per share Cents	2011 loss $'000	2011 weighted average number of 1p shares Thousand	2011 loss per share Cents
Basic and diluted loss per share	(5,495)	56,426	(9.74)	(2,400)	45,074	(5.32)

12. Goodwill

Group	$'000
Cost	
At 1 January 2011	790
Additions (note 32)	17,983
Foreign currency translation	(1)
At 31 December 2011	18,772
Foreign currency translation	39
At 31 December 2012	18,811
Impairment	
At 1 January 2011	–
At 31 December 2011	–
At 31 December 2012	–
Carrying amount	
At 31 December 2012	18,811
At 31 December 2011	18,772
At 1 January 2011	790

Goodwill is tested at least annually for impairment and whenever there are indications that goodwill might be impaired.

Goodwill is allocated to the Group's cash-generating units (CGUs) which are the Corero Network Security ("CNS") division and Resource EMS ("REMS"), part of the Corero Business Systems division.

As at 31 December the carrying amount of goodwill allocated to each of these CGUs is:

	Total 2012 $'000	Total 2011 $'000
CNS	17,983	17,983
REMS	828	789
	18,811	18,772

The recoverable amount for the CNS CGU was determined based on a value-in-use calculation using cash flow projections over a 10 year period (2011: 5 year period). The key assumptions for the value-in-use calculation are those regarding revenue growth and discount rates as summarised in the table below and commented on below.

	2012	2011
Forecast cash flow period	Years 1–2	Years 1–2
Extrapolated cash flow period	Years 3–10	Years 3–5
Cumulative annual growth rate (CAGR) for revenue used for the forecast/extrapolated period	14.3%	24.5%
Revenue growth rates used beyond the extrapolated period	1.5%	0%
Discount rate	11.2% and 15.6%	10.0%
Discount rate required for recoverable amount to equal carrying amount	–*	12.0%
Percentage reduction in forecast revenue for recoverable amount to equal carrying amount	–*	9.0%
Amount by which the CGU's recoverable amount exceeds its carrying amount	$0.1 million	$7.6 million

* negligible changes to the key assumptions would result in the carrying value of the goodwill allocated to that CGU being less than its recoverable amount.

Notes to the Financial Statements continued

- The pre-tax cash flows for the forecast period are derived from the most recent financial budget for the year ending 31 December 2013 and the plan for the year ending 31 December 2014 approved by the Board. The extrapolation for the period 2015 to 2022 is based on management estimates (with the key assumptions set out below).
- The future pre-tax cash flows are discounted by a weighted average cost of capital ("WACC") of 11.2% for the period in which CNS utilises tax losses carried forward to reduce tax payable to nil and a WACC of 15.6% thereafter once the cost of tax becomes relevant.
- The key assumptions underlying the cash flow projections and which the recoverable amount is most sensitive to are (i) the revenue growth rates forecast and extrapolated for the period 2013 to 2017 (ii) and the discount rate.

  i. The cash flow forecasts assume a CAGR revenue growth of 25.5% in the period 2013 to 2017 (43.3% for the period 2013 to 2014) and 4.0% for the period 2018 to 2022 (a CAGR of 14.3% for 10 year forecast period). The management of the Group believe these growth rates are appropriate for the forecasts following CNS' repositioning as a First Line of Defense in 2012, management changes, investment in product development (and the next generation product which is expected to be available by the end of 2013 which is expected to deliver a step change in revenue in 2014), channel partner enablement and marketing.

     These growth rates are supported by the fact that the IT security market is forecast to grow strongly for the foreseeable future. Gartner for instance forecast that the IT security market will grow by a CAGR of 8.9% in the period 2011 to 2016 and Infonetics forecast that the DDoS protection market will grow from $270 million in 2012 to $485 million in 2016 (CAGR 16%).

     The above market growth rates used in the future cash flow assumptions reflect that CNS is in the early stages of the commercial exploitation of its intellectual property. In addition, the business' strategy is to continue to develop its product and solution offerings to remain a market leader in its chosen markets thereby providing the opportunity to generate above market average growth rates.

     The growth rate assumed in the period beyond the 10 year extrapolation period of 1.5% is considered reasonable as historically IT spend has exceeded GDP growth.

  ii. The discount rate is based on a cost of equity using the Capital Asset Pricing Model with the key inputs being a risk-free interest rate estimate of 2.95% (based on 30 year US government bonds), comparable company betas, an equity risk premium of 5% and small company risk premium of 4.5%. The WACC has been assessed based on a long term cost of debt of 6.5% and a gearing level based on the Company gearing at 31 December 2012. The WACC used in the valuation reflects current market assessments of the time value of money and the risks specific to CNS.

As stated above, the valuation to support the value in use of the CNS CGU is highly sensitive to negligible changes in cash flow forecasts and discount rate assumptions, and there is no guarantee that the expected growth will be achieved. If the expected growth is not achieved, this could result in a requirement to impair the goodwill associated with the CNS CGU in the future. If the revenue growth in 2013 and 2014 is reduced by 10% (which in the assessment of management is reasonably possible) in 2013 and 2014, and the same reduction is made to overheads, this would result in an impairment of goodwill associated with the CNS CGU of $2.8 million. If the discount rate is increased by 10% (which in the assessment of management is reasonably possible), this would result in an impairment of goodwill associated with the CNS CGU of $4.5 million.

Apart from the considerations in determining the value in use of the CNS CGU described above, the management of the Group is not currently aware of any other reasonably possible changes that would necessitate changes in its key estimates.

The recoverable amount for the REMS CGU unit was determined based on a value-in-use calculation using cash flow projections over a five year period which is considered an appropriate period given the REMS business is a mature business with a demonstrable track record. The key assumptions for the value-in-use calculation are summarised in the table below:

	2012	2011
Forecast cash flow period	Years 1–2	Years 1–2
Extrapolated cash flow period	Years 3–5	Years 3–5
CAGR for revenue used in the forecast/extrapolated period	14.9%	6.9%
Revenue growth rates used beyond the extrapolated period	0%	0%
Discount rate	8.8% and 11.1%	10.0%
Discount rate required for recoverable amount to equal carrying amount	*	*
Percentage reduction in forecast revenue for recoverable amount to equal carrying amount	*	*
Amount by which the CGUs recoverable amount exceeds its carrying amount	$4.0 million	$2.8 million

* for the REMS CGU no reasonably possible changes to key assumptions would result in the carrying value of the goodwill allocated to that CGU equalling its recoverable amount.

13. Acquired intangible assets

Group	Computer software $'000	Customer relationships $'000	Total $'000
Cost			
At 1 January 2011	294	–	294
Disposals	(129)	–	(129)
Acquisition	5,925	197	6,122
Additions	61	–	61
Foreign currency translation	(3)	–	(3)
At 31 December 2011	6,148	197	6,345
Additions	237	–	237
Disposals	(425)	–	(425)
Foreign currency translation	8	–	8
At 31 December 2012	5,968	197	6,165
Amortisation			
At 1 January 2011	(286)	–	(286)
Disposals	129	–	129
Charge for year	(1,506)	(23)	(1,529)
At 31 December 2011	(1,663)	(23)	(1,686)
Disposals	425	–	425
Charge for year	(1,129)	(28)	(1,157)
Foreign currency translation	(8)	–	(8)
At 31 December 2012	(2,375)	(51)	(2,426)
Net book value			
At 31 December 2012	3,593	146	3,739
At 31 December 2011	4,485	174	4,659
At 1 January 2011	8	–	8

Company

The Company has no intangible fixed assets (2011: $nil).

Notes to the Financial Statements continued

14. Capitalised development expenditure

Group	$'000
Cost	
At 1 January 2011	1,657
Additions	1,754
Foreign currency translation	(34)
At 31 December 2011	3,377
Additions	3,174
Foreign currency translation	132
At 31 December 2012	6,683
Amortisation	
At 1 January 2011	(740)
Charge for year	(322)
Foreign currency translation	10
At 31 December 2011	(1,052)
Charge for year	(662)
Impairment	(382)
Foreign currency translation	(59)
At 31 December 2012	(2,155)
Net book value	
At 31 December 2012	4,528
At 31 December 2011	2,325
At 1 January 2011	917

The impairment recorded during the year of $382,000 (2011: $ nil) related to expenditure on certain products in the CNS division. Having identified that these products would not generate cash inflows in the future sufficient to support their full carrying value, management determined that an impairment should be recorded.

Company

The Company has no capitalised development expenditure (2011: $nil).

15. Property, plant and equipment

Group	Computer Equipment $'000	Fixtures and Fittings $'000	Office Equipment $'000	Leasehold Improvements $'000	Total $'000
Cost					
At 1 January 2011	245	59	65	96	465
Acquisition	1,305	468	176	202	2,151
Additions	954	5	5	12	976
Foreign currency translation	53	–	–	–	53
At 31 December 2011	2,557	532	246	310	3,645
Additions	706	22	–	74	802
Disposals	(924)	–	(8)	–	(932)
Reclassification	–	(2)	–	2	–
Foreign currency translation	19	3	3	6	31
At 31 December 2012	2,358	555	241	392	3,546
Depreciation					
At 1 January 2011	(205)	(43)	(65)	(96)	(409)
Acquisition	(1,154)	(419)	(150)	(169)	(1,892)
Charge for year	(243)	(19)	(7)	(6)	(275)
Foreign currency translation	(54)	–	–	–	(54)
At 31 December 2011	(1,656)	(481)	(222)	(271)	(2,630)
Disposals	908	–	8	–	916
Charge for the year	(505)	(17)	(12)	(32)	(566)
Reclassification	2	(4)	4	(2)	–
Foreign currency translation	(15)	(2)	(3)	(5)	(25)
At 31 December 2012	(1,266)	(504)	(225)	(310)	(2,305)
Net book value					
At 31 December 2012	1,092	51	16	82	1,241
At 31 December 2011	901	51	24	39	1,015
At 1 January 2011	40	16	–	–	56

Company

The Company has no property, plant and equipment (2011: $nil).

Notes to the Financial Statements continued

16. Investments in subsidiaries

Company	2012 $'000	2011 $'000
Net book value		
At 1 January	18,220	638
(Reduction)/additional investment in Corero Business Systems Limited	(10)	5,077
Investment in Corero Network Security, Inc.	7,558	12,785
Foreign currency translation	952	(280)
At 31 December	26,720	18,220

An amount of $6.9 million of the Company's investment in Corero Network Security, Inc., is held as a Loan Note instrument. These Loan Notes bear interest at 5% per annum that at the election of Corero Network Security, Inc. is payable quarterly or added to the principal amount. The Loan Notes are repayable on 31 October 2016.

The Company owns:

100% of the issued share capital of Corero Network Security, Inc., a company incorporated in Delaware, USA. The principal business of the company consists of the development and sale of hardware and software security products.

100% of the issued share capital of Corero Group Services Limited, a company incorporated and registered in England and Wales. The principal business of the company consists of providing administration services to the Group.

100% of the issued share capital of Corero Network Security (UK) Limited, a company incorporated and registered in England and Wales. The principal business of the company consists of providing sales and marketing services on behalf of Corero Network Security, Inc.

92% of the issued share capital of Corero Business Systems Limited, a company incorporated and registered in England and Wales. The principal business of the company consists of the development and sale of computer software, comprising finance and management information software, and services, primarily to the education and commercial sectors.

On 18 July 2011, the Board of Directors approved the establishment of a Corero Business Systems Limited Deferred Payment Share Plan ("Plan") in terms of which Corero Business Systems Limited can issue, at fair market value, (or the Company can sell) up to 10% of Corero Business Systems issued ordinary shares to employees. The purpose of the Plan is to incentivise the employees to profitably grow the business.

On 1 August 2011, Corero Business Systems Limited issued, at a market value of $6,600, 2,062 ordinary shares (comprising 7.0% of Corero Business Systems Limited issued ordinary shares) under the terms of the Plan to members of the Corero Business Systems management team.

On 16 October 2012, the Company sold, at a market value of $9,900, 295 Corero Business Systems Limited ordinary shares (comprising 1.0% of Corero Business Systems Limited issued ordinary shares) under the terms of the Plan to a member of the management team.

No directors of the Company can participate in the Plan.

17. Inventories

Group	2012 $'000	2011 $'000	2010 $'000
Gross inventory	1,340	1,130	–
Less: provision for impairment	(718)	(757)	–
Net inventory	622	373	–

Net inventory comprises only finished goods.

Company

The Company holds no inventory (2011: $nil).

18. Trade and other receivables

	Group			Company		
	2012 $'000	2011 $'000	2010 $'000	2012 $'000	2011 $'000	2010 $'000
Trade receivables	3,303	4,420	838	–	–	–
Less: provision for impairment	(16)	(49)	(16)	–	–	–
Net trade receivables	3,287	4,371	822	–	–	–
Amounts owed by subsidiaries	–	–	–	8,304	6,072	4,415
Other debtors	1,592	256	104	103	87	99
Prepayments and accrued income	686	677	348	–	3	–
	5,565	5,304	1,274	8,407	6,162	4,514

The banking facilities of the Group, summarised in note 20, are secured by assets of the group companies.

- Up to 80% of the trade receivables of Corero Network Security, Inc., included under 'Group', can be financed and are therefore secured for credit enhancements.
- Corero Business Systems Limited overdraft facility which is secured over the assets of Corero Business Systems Limited (including trade receivables) has a covenant which requires 150% trade receivables cover.

None of the Company's trade and other receivables are secured by collateral or credit enhancements.

Amounts due from Group undertakings are recoverable after more than one year from the reporting date.

The age of trade receivables not impaired but past due are as follows:

Group	2012 $'000	2011 $'000	2010 $'000
Not more than 3 months	1,285	1,225	385
More than 3 months but not more than 6 months	272	99	92
More than 6 months but not more than 1 year	134	124	8
More than one year	128	19	–
	1,819	1,467	485

The directors consider that the carrying amount of trade and other receivables approximates their fair value.

The maturity profile of trade and other receivables is set out in the table below:

	Group			Company		
	2012 $'000	2011 $'000	2010 $'000	2012 $'000	2011 $'000	2010 $'000
In one year or less, or on demand	4,442	5,059	1,271	–	3	99
In more than one year, but not more than five years	1,123	245	3	8,407	6,159	4,415
	5,565	5,304	1,274	8,407	6,162	4,514

The functional currency of trade and other receivables is set out in the table below:

	Group			Company		
	2012 $'000	2011 $'000	2010 $'000	2012 $'000	2011 $'000	2010 $'000
US dollars	2,322	3,647	–	–	–	–
UK pound	3,243	1,657	1,274	8,407	6,162	4,514
	5,565	5,304	1,274	8,407	6,162	4,514

The foreign currency denominated receivables are the reporting currency of the subsidiary in which they report. There is no impact on the Statement of Comprehensive Income from exchange rate movements as the Statement of Comprehensive Income of the subsidiary is denominated in the currency of the subsidiary.

19. Trade and other payables

	Group	Group	Group	Company
	2012 $'000	2011 $'000	2010 $'000	2010 $'000
Trade payables	1,018	1,363	255	–
Other taxation and social security	533	661	315	–
Other payables	290	345	5	–
Accruals	2,131	2,006	573	3
	3,972	4,375	1,148	3

None of the Group or Company's trade and other payables are secured by collateral or credit enhancements.

The Company had no trade or other payables in 2012 or 2011.

The directors consider that the carrying amount of trade and other payables approximates its fair value.

90% of the trade and other payables are due in less than 3 months.

The functional currency of trade and other payables is set out in the table below:

Group	2012 $'000	2011 $'000	2010 $'000
US dollars	1,443	2,473	–
UK pound	2,529	1,902	1,148
	3,972	4,375	1,148

The foreign currency denominated payables are the reporting currency of the subsidiary in which they report. There is no impact on the Statement of Comprehensive Income from exchange rate movements as the Statement of Comprehensive Income of the subsidiary is denominated in the currency of the subsidiary.

20. Borrowings

Group	2012 $'000	2011 $'000	2010 $'000
Current			
Accounts receivable financing facility	–	190	–
Fixed term loan	182	83	–
	182	273	–
Non-current			
Fixed term loan	197	167	–
8% Loan Notes	5,787	5,343	–
	5,984	5,510	–

Company

The Company has no borrowings (2011: $nil).

The accounts receivable financing facility bears interest at c.8% of the financed value. The facility limit is US$1.5 million. 80% of the eligible accounts receivable balance can be financed. The facility requires a minimum quick asset ratio covenant of 1.15:1.

The term loan comprises two term loans of $250,000 each which bear interest at 8.5% and are repayable over 33 months. The first term loan matures in October 2014. The second term loan matures in April 2015.

Interest on the 8% Loan Notes principal ($5.0 million) is at the election of Corero Network Security, Inc. payable bi-annually or added to the principal amount. Corero Network Security, Inc. has elected to add the interest to the principal. Rolled up interest at 31 December 2012 amounted to $0.8m. The Loan Notes are repayable on 2 March 2014.

Undrawn facilities at 31 December 2012 amounted to $813,000 comprising the Corero Business Systems Limited overdraft facility. The facility, if drawn, requires 150% trade receivables cover and is secured over the assets of Corero Business Systems Limited. In addition, the Company has provided a guarantee.

At 31 December 2012, the Group's liabilities have contractual maturities which are summarised below. These contractual maturities reflect the payment obligations which may differ from the carrying values of the liabilities at the balance sheet date.

	In one year or less, or on demand			More than one but less than five years		
Group	2012 $'000	2011 $'000	2010 $'000	2012 $'000	2011 $'000	2010 $'000
Trade and other payables	3,868	4,195	1,148	104	180	–
Borrowings	182	273	–	5,984	5,510	–
Total	4,050	4,468	1,148	6,088	5,690	–

	In one year or less, or on demand		
Company	2012 $'000	2011 $'000	2010 $'000
Trade and other payables	–	–	3
Total	–	–	3

Notes to the Financial Statements continued

21. Financial instruments

The Group's financial instruments are categorised as shown below:

	Book Value		
Group	**2012 $'000**	**2011 $'000**	**2010 $'000**
Financial assets			
Trade and other receivables	4,879	4,627	926
Cash	4,861	6,680	11,155
	9,740	11,307	12,081

	Book Value		
Group	**2012 $'000**	**2011 $'000**	**2010 $'000**
Financial liabilities			
Financial liabilities at amortised cost:			
Trade and other payables	3,972	4,375	1,148
Accounts receivable financing	–	190	–
Fixed term loan	379	250	–
8% Loan Notes	5,787	5,343	–
	10,138	10,158	1,148

There are no differences between the fair values and book values held by the Group and Company.

22. Deferred income

Group	2012 $'000	2011 $'000	2010 $'000
Current	7,592	8,390	2,306
More than one year but less than five years	1,146	1,252	–
	8,738	9,642	2,306

The company's deferred income balance that is presented as falling due in less than one year will be recognised as revenue evenly over the remaining term of the support agreements in place. Support agreements expire at various times throughout the year with no particular seasonality.

Company

The Company has no deferred income (2011: $nil).

23. Deferred tax liability

Group	$'000
1 January 2011	–
Addition	1,875
Credit to income statement	(308)
31 December 2011	1,567
Credit to income statement	(371)
31 December 2012	1,196

The deferred tax liability relates to the software and customer relationships acquired as part of the Top Layer Networks, Inc. acquisition (note 32). The deferred tax liability has been calculated using a US Federal tax rate of 34%. The liability is released to the Statement of Comprehensive Income as the intangible software and customer relationship assets are amortised.

24. Pensions

The Group's pension arrangements are operated through defined contribution schemes.

Defined contribution schemes

	2012 $'000	2011 $'000
Defined contribution pension costs	151	122

Notes to the Financial Statements continued

25. Share capital

Authorised share capital

The authorised share capital comprises 745,821,970 (2011: 745,821,970) ordinary shares of 1p (1.63c) each and 1,518,990 (2011: 1,518,990) deferred shares of £2.99 ($4.64) each.

Issued ordinary share capital

	$'000
1 January 2011	
31,963,434 ordinary shares of 1p each (1.55c)	496
Issued	
9,038,855 ordinary shares of 1p each (1.63c)	147
6,571,429 ordinary shares of 1p each (1.63c)	107
140,000 ordinary shares of 1p each (1.62c)	2
31 December 2011	
47,713,718 ordinary shares of 1p each	752
Issued	
10,615,694 ordinary shares of 1p each (1.58c)	168
308,000 ordinary shares of 1p each (1.60c)	5
31 December 2012	
58,637,412 ordinary shares of 1p each	925

On 6 March 2012, 10,615,694 ordinary shares with a nominal value of 1p were issued at 43p (68c) per share by way of a placing.

On 8 November 2012, 308,000 ordinary shares with a nominal value of 1p were issued at 25p (40c) per share by way of exercise of options.

Deferred share capital

The deferred share capital consists of 1,518,990 deferred shares of £2.99 ($4.64) each.

	$'000
31 December 2010	7,051
31 December 2011	7,051
31 December 2012	7,051

The deferred shares have no voting or dividend rights and, on a return of capital, will have the right to receive the amount paid up thereon after the holders of the ordinary shares have received, in aggregate, the amount paid up thereon plus £10,000,000 ($16,259,000) per ordinary share. The deferred shares are not transferable (save with the consent of the Directors). The Company may, at any time, transfer the deferred shares to any other person or buy back the deferred shares, for an aggregate payment of 1p (1.63c).

26. Share premium

	$'000
1 January 2011	22,262
9,038,855 ordinary shares at 38p (62c) each less issue costs	5,421
6,571,429 ordinary shares at 34p (55c) each less issue costs	3,457
140,000 ordinary shares at 39p (63c) each	88
31 December 2011	31,228
10,615,694 ordinary shares at 42p (66c) less issue costs	6,700
308,000 ordinary shares at 24p (38c)	118
31 December 2012	38,046

Consideration received in excess of the nominal value of the 10,615,694 shares issued on 6 March 2012 as a result of the placing has been included in share premium, less registration, placing commission and professional fees of $340,000. The amount of such directly attributable costs deducted from share premium in 2011 was $435,000.

27. Employees and directors

Employee expenses during the period

Group	Total 2012 $'000	Total 2011 $'000
Wages and salaries	15,554	11,702
Social security costs	1,704	1,045
Other pension costs (note 24)	151	122
Cost of employee share scheme (note 30)	9	32
	17,418	12,901

Average monthly numbers of employees (including directors) employed

Group	Total 2012 Number	Total 2011 Number
Sales and Marketing	47	38
Consulting and Professional Services	26	11
Technical and Support	52	46
Administration	19	11
	144	106

Company

The Company has no employees (2011: nil).

Notes to the Financial Statements continued

Directors

	Salary & fees $'000	Bonus $'000	Benefits $'000	Pension $'000	Share based payments $'000	Total 2012 $'000	Total 2011 $'000
Executive director							
Andrew Miller	228	95	6	21	–	350	350
Non-executive directors							
Richard Last	28	–	–	–	2	30	24
Jens Montanana	38	–	–	–	3	41	24
Andrew Lloyd (appointed 19 November 2012)	4	–	–	–	–	4	–
Edward Forwood (resigned 19 March 2012)	–	–	–	–	–	–	–
Stephen Graham (appointed 19 March, resigned 30 June 2012)	–	–	–	–	–	–	–
	298	95	6	21	5	425	398

Bonus payments of $95,000 were awarded to the executive director during the period to 31 December 2012 (2011: $109,000).

Andrew Miller has a service contract with a 5 month notice period. A subsidiary company provides for pension contributions of 10% of basic salary payable to a personal pension plan.

No directors were accruing benefits from the Group's defined contribution pension arrangements (2011: nil).

Post the year end, Jens Montanana notified the Company that he wished to waive his non-executive director fees for the year ended 31 December 2012. Jens Montanana waived his non-executive director fees for the year ended 31 December 2011.

28. Operating lease commitments

The Group has total future minimum lease payments under non-cancellable operating leases totalling $1,083,000 (2011: $1,458,000) analysed by year of expiry as follows:

Group	2012 $'000	2011 $'000
Land and building agreements expiring:		
Within one year	26	37
Within two to five years	1,057	1,421
	1,083	1,458

Company

The Company has no operating lease commitments (2011: $nil).

29. Contingent liabilities

The Group and Company do not have any contingent liabilities (2011: $nil).

On 17 March 2011, the Corero Remuneration Committee approved the establishment of the Corero Early Exit Incentive Plan ("EEIP"). The EEIP is a cash settled change of control incentive plan for the senior executives of the Group that provides for a cash payment in the event of (i) a sale of substantially all of the assets of the Corero Network Security business, or (ii) an offer for all of the shares of Corero Network Security plc, in the period up to 30 April 2014 (thereafter it will lapse).

The cash incentive payment is determined based on the difference between (i) the value of the transaction (consideration for the sale of all or substantially all of the assets of Corero Network Security, Inc. or offer for all of Corero Network Security plc's shares) and (ii) Corero Network Security plc's accumulated cost of capital comprising the cash investment by Corero Network Security plc shareholders and shares issued for acquisitions or other purposes, defined as the "Total Gain". The EEIP will pay those executives granted the incentive a percentage of the Total Gain. Under the terms of the EEIP, awards up to a maximum of 3.0% of the Total Gain can be issued with a maximum of 0.5% per individual. At 31 December 2012, EEIP awards comprising 1.7% of the Total Gain had been awarded (including an award of 0.5% to Andrew Miller, a Company director).

As at the date of this report no discussions are in progress or contemplated which would result in the incentive payment being payable. As a result no provision has been recorded in the financial statements relating to the EEIP.

30. Share options

The Company has the following share option schemes:

- Enterprise Management Incentive Scheme for its employees, which has been approved by HMR&C
- 2010 Executive Enterprise Management Incentive Scheme, which has been approved by HMR&C
- 2010 Unapproved Share Option Scheme
- Deferred Payment Share Plan

In August 2010, 1,257,000 options were granted to certain directors and employees under the 2010 Executive Enterprise Management Incentive scheme and 2010 Unapproved Share Option Scheme. The options granted vested immediately upon grant.

All other options granted in 2010-2012 have a three year vesting period, vesting one third on the first anniversary of grant, one third on the second anniversary of grant and one third on the third anniversary of grant. There are no vesting conditions.

Share options granted at 31 December 2012 were as follows:

Option Holders	Date granted	Expiry date	Exercise price	At 1 January 2012	Granted	Exercised	Lapsed/ cancelled	At 31 December 2012
Enterprise Management Incentive Scheme								
Other Holders	January 2002	January 2012	825p (1,341c)	500	–	–	(500)	–
	January 2003	January 2013	735p (1,195c)	633	–	–	–	633
	October 2003	October 2013	1,095p (1,780c)	333	–	–	–	333
	February 2005	February 2015	495p (805c)	2,200	–	–	–	2,200
	April 2006	April 2016	555p (902c)	5,361	–	–	–	5,361
	September 2008	September 2018	300p (488c)	27,334	–	–	(2,000)	25,334
	March 2011	March 2021	36p (59c)	40,750	–	–	(33,750)	7,000
	March 2011	March 2021	40p (65c)	165,000	–	–	–	165,000
	March 2012	March 2022	54.5p (89c)	–	37,500	–	(7,500)	30,000
	September 2012	September 2022	43p (70c)	–	110,000	–	–	110,000
2010 Executive Enterprise Management Incentive Scheme								
Andrew Miller	August 2010	August 2020	25p (41c)	476,000		–	–	476,000
	September 2012	March 2022	54.5p (89c)	–	80,000	–	–	80,000
2010 Unapproved Share Option Scheme								
Andrew Miller	March 2012	March 2022	54.5p (89c)	–	80,000		(80,000)	–
Jens Montanana	August 2010	August 2020	25p (41c)	165,000	–	–	–	165,000
	March 2012	March 2022	54.5p (89c)	–	30,000	–	–	30,000
Richard Last	March 2012	March 2022	54.5p (89c)	–	20,000	–	–	20,000
Other holders	August 2010	August 2020	25p (41c)	308,000	–	(308,000)	–	–
	August 2010	August 2020	31p (50c)	308,000	–	–	–	308,000
	March 2011	March 2021	36p (59c)	427,333			(180,750)	246,583
	March 2011	March 2021	40p (65c)	440,000		–	(135,000)	305,000
	May 2011	May 2021	35p (57c)	190,000		–	(80,000)	110,000
	September 2011	September 2021	37.5p (61c)	486,500		–	(47,500)	439,000
	March 2012	March 2022	54.5p (89c)	–	1,122,250	–	(88,000)	1,034,250
	September 2012	September 2022	43p (70c)	–	146,000	–	–	146,000
Unapproved Share Option Scheme								
Other holders	April 2008	April 2017	555p (902c)	8,772	–		–	8,772
				3,051,716	1,625,750	(308,000)	(655,000)	3,714,466

The closing mid market price for the Company's shares at 31 December 2012 was 32.5p (53c) and the high and low for the year was 60.5p (94c) and 29.5p (47c). There are no performance conditions to be met before share options are exercisable.

Changes in directors options held between 1 January 2012 and the 31 December 2012 are detailed in the following table:

	At 1 January 2012	Granted during year	Cancelled during year	At 31 December 2012	Exercise price	Date from which partially exercisable	Expiry date
Andrew Miller	476,000	–	–	476,000	25p (41c)	August 2010	August 2020
	–	80,000	(80,000)	–	54.5p (89c)	n/a	n/a
	–	80,000	–	80,000	54.5p (89c)	March 2013	March 2022
Richard Last	–	20,000	–	20,000	54.5p (89c)	March 2013	March 2022
Jens Montanana	165,000	–	–	165,000	25p (41c)	August 2010	August 2020
	–	30,000	–	30,000	54.5p (89c)	March 2013	March 2022

In addition, Andrew Miller has a contractual right (granted in March 2011) to purchase 140,000 ordinary shares in the Company from the Employee Share Ownership Trust at 40p per share pursuit to a grant made to him under the Deferred Payment Share Plan.

None of the directors holding office at the balance sheet date exercised options during the year.

Share based payments

The Remuneration Committee can grant options to employees of the Group under the Group's share option schemes.

Options are granted with a fixed exercise price which is equal to the market price at the date of the grant or higher price determined by the Remuneration Committee. The contracted life is ten years from the date of grant.

Options are valued using the Black-Scholes option-pricing model.

Options granted during 2012

The value of options granted during the year was calculated using the Black-Scholes option pricing model. The following variables and ranges were used:

Share price at date of grants	43p–54.5p (70c–89c)
Exercise price	43p–54.5p (70c–89c)
Expected volatility	0.2%–0.3%
Years to maturity	9.68–9.73
Risk free interest rate	0.63%–1.25%

Notes to the Financial Statements continued

The following table provides information on all options outstanding at the end of the year:

Weighted average remaining contractual life	8.3 years
Exercise price range	25p–1,095p (41c–1,780c)
Weighted average share price	43.5p (71c)
Weighted average exercise price	44p (72c)
Expected volatility	0.2%–10.7%
Risk free rate – 5 year gilt rate	0.63%–5.3%
Expected dividend yield	Nil

The total charge in the year relating to employee share based payments was $9,000 (2011: $32,000).

31. Related parties and transactions

Related party transactions subsist between Group companies and relate to costs paid on behalf of the parent Company. The 2012 costs paid by other Group companies on behalf of the parent Company were $342,000 (2011: $308,000).

The directors consider the Group's key management personnel to be the Board of directors of the Company and the Chief Executive Officers of Corero Network Security, Inc. and Corero Business Systems Limited whose compensation is detailed below:

	Salary & fees $'000	Bonus $'000	Benefits $'000	Pension $'000	Share based payments $'000	2012 $'000	2011 $'000
Key management personnel	744	223	18	21	19	1,025	1,069

Company key management compensation was $nil (2011: $nil) as the key management are employed by subsidiaries.

32. Acquisition

On 2 March 2011, in the prior period, the Company acquired the entire issued share capital of Top Layer Networks, Inc. which has since been renamed Corero Network Security, Inc.

The aggregate consideration for the acquisition was $15,288,160 satisfied as follows:

- $6,304,602 by the issue, credited as fully paid, of 9,038,855 new ordinary shares of Corero Network Security plc;
- $5,000,000 by the issue of loan notes by Top Layer. These loan notes bear interest at 8% per annum and are repayable on 2 March 2014;
- $3,860,000 in cash; and
- Deferred consideration of $123,558, to be satisfied by the issue of 177,145 new ordinary shares in the Company to be issued on 2 September 2012 subject to adjustment for set off against any warranty claims brought by the Company in accordance with the terms of the acquisition agreement. These shares were treated as a component of equity.

The assets and liabilities of Top Layer at the date of acquisition were:

	Book value $'000	Fair value $'000
Property, plant and equipment	259	259
Other non-current assets	137	137
Inventory	222	222
Trade and other receivables	1,336	1,336
Cash and cash equivalents	211	211
Trade and other payables	(2,104)	(2,104)
Other short term financial liabilities	(590)	(590)
Deferred income	(6,310)	(6,310)
Other non-current liabilities	(302)	(302)
Net liabilities	(7,141)	(7,141)
Deferred taxation	(1,875)	(1,875)
Goodwill		17,983
Customer contracts and related customer relationships		197
Software		5,320
Satisfied by consideration		14,484
Consideration comprises:		
Completion consideration shares		5,500
Loan notes		5,000
Cash		3,860
Deferred consideration shares		124
Total consideration		14,484

The revenue and loss of Top Layer since the acquisition date included in the Statement of Comprehensive Income for the year ended 31 December 2011 is shown in note 5 under the heading Corero Network Security. The consolidated revenue and loss before taxation for the year ended 31 December 2011 as though the acquisition date had been effective as of the beginning of the annual reporting period would have been $12,417,000 and $3,426,000 respectively.

33. Post balance sheet event

On 20 March 2013, the Company raised $6.2 million (£4.1 million) (before issue costs), of which the directors contributed $4.2 million (£2.8 million), by way of a placing and subscription of 27,000,004 new ordinary shares at a price of 15p per share. The funds were raised for the ongoing funding of the Corero Network Security division and development of its next generation product.

Notice of AGM

Notice is hereby given that the annual general meeting (the "AGM") of Corero Network Security plc (the "Company") will be held at the offices of finnCap Ltd, 60 New Broad Street, London, EC2M 1JJ, on 13 June 2013 at 10.00 a.m. for the following purposes:

Ordinary Business

To consider and, if thought fit, pass the following resolutions which will be proposed as ordinary resolutions:

1. Report and accounts

To receive the audited annual accounts of the Company for the year ended 31 December 2012, together with the directors' report and the auditor's report on those annual accounts.

2. Re-election of director

To re-elect Mr Jens Montanana, who retires by rotation in accordance with the Company's articles of association, as a director of the Company.

3. Re-election of director

To re-elect Mr Andrew Miller, who retires by rotation in accordance with the Company's articles of association, as a director of the Company.

4. Re-election of director

To re-elect Mr Andrew Lloyd, who retires in accordance with the Company's articles of association, as a director of the Company.

5. Re-appointment of auditors

To re-appoint BDO LLP as auditors of the Company to hold office from the conclusion of this AGM until the conclusion of the next annual general meeting at which accounts are laid before the Company.

6. Auditors' remuneration

To authorise the directors to determine the remuneration of the auditors.

Special Business

To consider and, if thought fit, pass the following resolutions of which resolution 7 will be proposed as an ordinary resolution and resolutions 8 and 9 will be proposed as special resolutions:

7. Directors' authority to allot shares

THAT, in substitution for all existing and unexercised authorities and powers granted to the Directors prior to the date of this resolution in accordance with section 551 of the Companies Act 2006 ("Act"), the Directors be generally and unconditionally authorised for the purposes of section 551 of the Act to exercise all the powers of the Company to allot shares in the Company and grant rights to subscribe for or to convert any security into shares of the Company (such shares and rights to subscribe for or to convert any security into shares of the Company being "relevant securities") up to a maximum nominal amount of £285,458.05 on such terms and conditions as the Directors may determine provided that, unless previously revoked, varied or extended, this authority shall expire on the earlier of the date falling 15 months after the date of the passing of this resolution and the conclusion of the next annual general meeting of the Company except that the Company may at any time before such expiry make an offer or agreement which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such an offer or agreement as if this authority had not expired.

8. Disapplication of pre-emption rights

THAT, in substitution for all existing and unexercised authorities and powers granted to the Directors prior to the date of this resolution in accordance with section 570(1) of the Act and subject to and conditional on the passing of resolution 7, the Directors be and are hereby empowered to allot equity securities (as defined in section 560(1) of the Act) of the Company for cash, pursuant to the authority of the Directors under section 551 of the Act conferred by resolution 7 above, and/or by way of a sale of treasury shares for cash (by virtue of section 573 of the Act), in each case as if section 561(1) of the Act did not apply to such allotment, provided that this power shall be limited to:

(a) the allotment of equity securities in connection with an offer by way of a rights issue (i) to the holders of ordinary shares in proportion (as nearly as may be practicable) to their respective holdings and (ii) to holders of other equity securities as required by the rights of those securities or as the Directors otherwise consider necessary, but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to treasury shares, fractional entitlements, record dates, legal or practical problems in or under the laws of any territory or the requirements of any regulatory body or stock exchange; and

(b) the allotment and/or sale of treasury shares for cash (otherwise than pursuant to resolution 8(a) above) of equity securities up to a maximum nominal amount of £85,637.42,

and that, unless previously revoked, varied or extended, this power shall expire on the earlier of the date falling 15 months after the date of the passing of this resolution and the conclusion of the next annual general meeting of the Company except that the Company may before the expiry of this power make an offer or agreement which would or might require equity securities to be allotted (and treasury shares to be sold) after such expiry and the Directors may allot equity securities (and sell treasury shares) in pursuance of such an offer or agreement as if this power had not expired.

9. Authority to purchase Company's own shares

THAT the Company be generally and unconditionally authorised for the purposes of section 701 of the Act to make market purchases (as defined in section 693(4) of the Act) on a recognised investment exchange (as defined in section 693(5) of the Act) of ordinary shares of £0.01 each in the capital of the Company ("Ordinary Shares") and to hold such shares as treasury shares (as defined in section 724(3) of the Act) provided that:

(a) this authority shall be limited to the purchase of Ordinary Shares up to a maximum aggregate nominal value equal to £85,637.42 representing approximately 10 per cent. of the nominal value of the current issued ordinary share capital of the Company;

(b) the minimum price which may be paid for such Ordinary Shares is £0.01 (exclusive of expenses);

(c) the maximum price (exclusive of expenses) which may be paid for an Ordinary Share shall not be more than 5 per cent. above the average middle market quotations for an Ordinary Share on the relevant recognised investment exchange on which Ordinary Shares are traded for the five business days immediately preceding the date on which the Ordinary Share is purchased;

(d) unless previously revoked, varied or extended, the authority hereby conferred shall expire at the earlier of the date which is 15 months from the date of the passing of this resolution and the conclusion of the next annual general meeting of the Company; and

(e) the Company may make a contract or contracts to purchase Ordinary Shares under the authority hereby conferred prior to the expiry of such authority which will or may be executed wholly or partly after the expiry of such authority and may make a purchase of Ordinary Shares in pursuance of any such contract or contracts.

By order of the Board

Duncan Swallow

Company Secretary
25 March 2013

Registered Office:

169 High Street
Rickmansworth
Hertfordshire
United Kingdom
WD3 1AY

Notice of AGM continued

Notes:

1. Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001 (as amended), only those members registered in the register of members of the Company at 6.00 p.m. on 11 June 2013 (or if the AGM is adjourned, on the day which is two business days before the time fixed for the adjourned AGM) shall be entitled to attend and vote at the AGM in respect of the number of shares registered in their name at that time. Any changes to the register of members after such time shall be disregarded in determining the rights of any person to attend or vote at the AGM.

2. CREST members who wish to appoint a proxy or proxies through the CREST electronic proxy appointment service may do so for the AGM to be held at 10.00 a.m. on 13 June 2013 and any adjournment(s) thereof by using the procedures described in the CREST Manual. CREST personal members or other CREST sponsored members, and those CREST members who have appointed a voting service provider should refer to their CREST sponsors or voting service provider(s), who will be able to take the appropriate action on their behalf.

   In order for a proxy appointment or instruction made by means of CREST to be valid, the appropriate CREST message (a "CREST Proxy Instruction") must be properly authenticated in accordance with Euroclear UK & Ireland Limited's specifications and must contain the information required for such instructions, as described in the CREST Manual. The message must be transmitted so as to be received by the Company's agent, Capita Registrars Limited (CREST Participant ID: RA1 0), no later than 10. 00 a.m. on 11 June 2013. For this purpose, the time of receipt will be taken to be the time (as determined by the time stamp applied to the message by the CREST Application Host) from which the Company's agent is able to retrieve the message by enquiry to CREST in the manner prescribed by CREST.

   CREST members and, where applicable, their CREST sponsor or voting service provider should note that Euroclear UK & Ireland Limited does not make available special procedures in CREST for any particular messages. Normal system timings and limitations will therefore apply in relation to the input of CREST Proxy Instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member or sponsored member or has appointed a voting service provider, to procure that his CREST sponsor or voting service provider takes) such action as shall be necessary to ensure that a message is transmitted by means of the CREST system by any particular time. In this connection, CREST members and, where applicable, their CREST sponsor or voting service provider are referred in particular to those sections of the CREST Manual concerning practical limitations of the CREST system and timings.

   The Company may treat as invalid a CREST Proxy Instruction in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.

3. If you wish to attend the AGM in person, you should make sure that you arrive at the venue for the AGM in good time before the commencement of the meeting. You may be asked to prove your identity in order to gain admission.

4. A member who is entitled to attend, speak and vote at the AGM may appoint a proxy to attend, speak and vote instead of him. A member may appoint more than one proxy provided each proxy is appointed to exercise rights attached to different shares (so a member must have more than one share to be able to appoint more than one proxy). A proxy need not be a member of the Company but must attend the AGM in order to represent you. A proxy must vote in accordance with any instructions given by the member by whom the proxy is appointed. Appointing a proxy will not prevent a member from attending in person and voting at the AGM (although voting in person at the AGM will terminate the proxy appointment). A proxy form is enclosed. The notes to the proxy form include instructions on how to appoint the Chairman of the AGM or another person as a proxy. You can only appoint a proxy using the procedures set out in these Notes and in the notes to the proxy form.

5. To be valid, a proxy form, and the original or duly certified copy of the power of attorney or other authority (if any) under which it is signed or authenticated, should reach the Company's registrar, Capita Registrars, PXS, 34 Beckenham Road, Beckenham BR3 4TU, by no later than 10.00 a.m. on 11 June 2013.

6. In the case of joint holders of shares, the vote of the first named in the register of members who tenders a vote, whether in person or by proxy, shall be accepted to the exclusion of the votes of other joint holders.

7. A member that is a company or other organisation not having a physical presence cannot attend in person but can appoint someone to represent it. This can be done in one of two ways: either by the appointment of a proxy (described in Notes 2 and 4 to 6 above) or of a corporate representative. Members considering the appointment of a corporate representative should check their own legal position, the Company's articles of association and the relevant provision of the Companies Act 2006.

8. The following documents are available for inspection at the registered office of the Company during usual business hours on any weekday (Saturday, Sunday or public holidays excluded) from the date of this notice until the conclusion of the AGM and will also be available for inspection at the place of the AGM from 9.00 am on the day of the AGM until its conclusion:

   (a) copies of the executive directors' service contracts with the Company and any of its subsidiary undertakings; and

   (b) letters of appointment of the non-executive directors.

Advisors

Directors

Jens Montanana (Non-executive Chairman)
Andrew Miller (Executive Director)
Richard Last (Non-executive Director)
Andrew Lloyd (Non-executive Director)

Secretary and Registered Office

Duncan Swallow
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Rickmansworth
Hertfordshire
WD3 1AY

Nominated Adviser and Broker

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60 New Broad Street
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EC2M 1JJ

Auditor

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Lockton House
Clarendon Road
Cambridge
CB2 8FH

Solicitors

Dorsey and Whitney LLP
21 Wilson Street
London
EC2M 2TD

Bankers

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